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

PART 19

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SELECT COMMITTEE ON INVESTIGATION OF THE BUREAU OF INTERNAL REVENUE

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INVESTIGATION OF BUREAU OF INTERNAL REVENUE

Pursuant to permission to reply after June 1, 1925 (page 3208), the following, with criticisms of committee's staff, is submitted for the record by Mr. Manson, general counsel for the committee:

TREASURY DEPARTMENT,
Washington, July 9, 1925.

Hon. JAMES COUZENS,
Chairman Senate Investigating Committee,
United States Senate.

MY DEAR SENATOR: I am attaching hereto memoranda which have been prepared in reply to the criticisms of the Senate investigating committee in the cases of Dill & Collins Co., Philadelphia, Pa.; Watab Pulp & Paper Co., Sartell, Minn.; and Westinghouse Air Brake Co., of Pittsburgh, Pa.

Will you be good enough to have these memoranda inserted in the official records of the investigating committee?

Sincerely yours,

D. H. BLAIR, *Commissioner.*

DILL & COLLINS CO., 140 NORTH SIXTH STREET, PHILADELPHIA, PA., CALENDAR YEARS 1917 AND 1918

This case presents two issues:

(1) Whether the then natural resources audit division had jurisdiction over the determination of depreciation in the audit of returns coming under the category of "timber concerns," and

(2) Whether the rate of 10 per cent depreciation on machinery of a paper and pulp concern is unreasonable.

With respect to the jurisdictional question, will suffice to call attention to the various office orders of the Income Tax Unit, outlining the organization of the unit, and the functions of the respective divisions. Special attention is called to office order No. 239 (February 2, 1920), paragraph No. 52, which is as follows:

"The timber valuation section, which will determine the value of timber property as of dates significant under the law, and determine reasonable depletion deductions in connection with these returns."

Numerous reorganizations have occurred subsequent thereto, and by reference to office orders outlining the functions of the respective divisions in consequence of such reorganizations the functions of the timber valuation section will be seen to have remained the same. Refer to office orders No. 420, October 1, 1920; No. 597, October 20, 1921; No. 621, January 3, 1922; and No. 715, February 21, 1923.

With respect to issue No. 2, as to whether a rate of 10 per cent depreciation on machinery of a paper and pulp concern is unreasonable, it will be recognized that no set formula can be applied to such a mooted question, but that all factors entering into each case must be considered and determined on the merits of the specific case.

The main factor recognized in the instant case in allowing a rate of 10 per cent depreciation on machinery for the years 1917 and 1918 was that the plant was in continuous operation 24 hours a day. A rate of 6½ per cent was recognized as normal depreciation and a 50 per cent increase was allowed to take care of the abnormal conditions existing during the years 1917 and 1918. It was universally recognized by the Income Tax Unit that during the years

1917 and 1918 conditions were generally upset on account of the war; that it was practically impossible to secure efficient help, and as a consequence taxpayers were at a disadvantage to keep their plants and machinery in working condition.

The normal depreciation of any unit is recognized to represent the wear and tear from usage during normal operating time, which in most plants is eight hours. It, therefore, must be recognized that as the result of a 24-hour operation, as in the instant case, unusual strain must naturally follow.

The Government departments during the war recognized accelerated depreciation for operating time above normal on cost-plus contracts and allowed contractors accelerated depreciation on all overtime work, and cognizance was taken of this by the Income Tax Unit in allowing approximately a 50 per cent increase to taxpayers for depreciation where such conditions existed.

Section 214(a)8 of the revenue act of 1918 provides—

"* * * That in computing net income there shall be allowed as deductions:

"'A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business. * * *.'"

and after taking all the facts into consideration in the instant case, it is the judgment and opinion of the unit that the depreciation allowed on machinery is reasonable and fair to both the Government and the taxpayer.

J. G. BRIGHT,
Deputy Commissioner.

OCTOBER 26, 1925.

To: Mr. L. C. Manson, general counsel.
From: Mr. L. H. Parker, chief engineer.
Subject: Reply of bureau, Dill & Collins case.

We have at hand a reply from the bureau dated July 9, 1925, to certain criticisms made by us in course of the hearings in regard to the settlement of the Dill & Collins case.

This reply of the bureau, signed by Mr. Bright, discusses the two main issues raised.

The first issue is to fix the jurisdiction for the determination of depreciation rates to the auditors or to the engineers of the timber section. As we understand Mr. Bright's reply, the jurisdiction of the engineers is simply over valuations and over depletion allowances, and they have no authority over depreciation rates. This is precisely the point we wished to establish, for we do not consider the office orders allocating authority for depreciation allowances to the auditors sound. What happened in the Dill & Collins case under this procedure is briefly as follows:

An engineer of wide practical training in the paper and pulp industry, having had many years' experience in the design, construction, and operation of paper and pulp plants, makes a determination of the proper depreciation rates in this case. He not only studies the case and has a conference with the taxpayer, but he makes an actual field inspection of the plants.

A conferee auditor and an auditor hold a conference, neither of whom have seen the plants or have an intimate knowledge of the machinery problem of the paper and pulp industry. These auditors set up a much larger rate of depreciation. Moreover, at the conference they do not call in the original engineer or any other engineer of the timber section.

The bureau accepts the auditors' rates for depreciation in this case and discards the engineer's. We understand from Mr. Bright's reply that he approves of auditors having jurisdiction over depreciation and that this is the regular system. We contend that the qualifications of the auditor and the engineer in this case, as shown above, make it obvious that in such cases the engineer should have jurisdiction and that, therefore, the system should be criticized. This is exactly the point we wished to make in this case.

The second issue discussed by Mr. Bright is the question of whether on machinery a 6½ per cent rate set by the engineer or a 10 per cent rate set by the auditor is reasonable. Mr. Bright approves of the 10 per cent rate on the basis that the plant would normally work 8 hours a day, but during 1917, 1918, and 1919 it worked 24 hours a day. Hence excessive depreciation.

The following quotations from the record we believe disprove the above theory:

"Mr. Robertson (the engineer) stated that it was a universal custom of the pulp and paper industry to work 24 hours a day and that the machinery was designed for that purpose.

"That the taxpayer's method of taking the appraisal made as of January 30, 1913, and then depreciating same on 2 per cent and 4 per cent to obtain sound values as of the taxable year and then to claim depreciation of 10 per cent from then on is not a true reflection of the actual economic waste.

"It is recommended that the rates of 2½ per cent on buildings and 6¼ per cent on machinery be allowed in the instant case for years 1917 through 1920, which are sufficiently above normal rates for those years to allow for the extraordinary conditions that then existed."

From the above it can be seen that while Mr. Bright contends 10 per cent is all right as being 50 per cent above the normal rate, which is proper on account of a 24-hour shift instead of an 8-hour shift; the engineer shows that a 24-hour shift is normal, and that the extra depreciation due to other extraordinary war conditions have already been taken into account in fixing the 6¼ per cent rate which is of itself above normal.

We are obliged then to confirm our approval of the original report of our investigating engineer, Mr. Vassar, as submitted in this case.

Respectfully submitted.

L. H. PARKER,
Chief Engineer.

MEMORANDUM

JUNE 8, 1925.

Mr. C. R. NASH,
Assistant to the Commissioner.

In re Watab Pulp and Paper Co., Sartell, Minn.

Reference is made to the memorandum dated May 19, 1925, of the Senate investigating committee criticizing the unit's action in respect to the depreciation allowance for the years 1917, 1918, and 1919. The investigating committee states that the opinions of the engineering division rather than the audit's section should be followed in the adjustment of the case.

It appears that the agent's report submitted under date of July 29, 1920, proposed an additional tax of $137,052.95 for the years 1909 to 1919, inclusive. An office audit made in the old field audit review section reduced the proposed additional tax to $51,132.17. A letter showing the latter amount of additional tax and mailed to the taxpayer on April 16, 1921. The taxpayer immediately protested and upon the order of Mr. Batson (who was deputy commissioner at that time) the assessment was removed from proving section's list until the matter could be thrashed out.

The additional tax as proposed by the unit on the agent was due principally to the reduction made to surplus as at December 31, 1916, on account of depreciation not taken in prior years. The taxpayer claimed on its 1917 to 1919 return depreciation at the rate of 5 per cent in its entire plant. Depreciation for the earlier years was not computed at any fixed rate and the amounts written off were much smaller than the amounts deducted in years 1917 to 1919.

A conference was held between the taxpayer's representative and the conferee of the field audit review section on July 18, 1921. The matter of depreciation was discussed and the taxpayer's representative stated that additional data would be submitted for the purpose of substantiating the accelerated rate of depreciation claimed for the years 1917 to 1919. This additional data was submitted under date of September 30, 1921. The case was then transferred to the natural resources division. A conference was held with the taxpayer's representative by audit F section on November 26, 1921. The case was next referred to Mr. Robertson an engineer of the timber division.

The point at issue as mentioned in the foregoing paragraph is the reduction of surplus at December 31, 1916, on account of depreciation not taken in the earlier years. The taxpayer contends that in accordance with the provisions of A. R. M. 106, its surplus at December 31, 1916, should not be disturbed. The agent proposed a reduction at December 31, 1916, of approximately $420,773.60 for the depreciation not taken in prior years. The valuation report made by the timber section under date of November 20, 1921, indicates that a reduction of approximately $300,000 should be made to surplus as at December 31, 1916. Audit F section allowed the taxpayer's contention and the A-2 letter was mailed September 19, 1922, indicating a net additional tax of $5,054.80.

It is noted as stated previously that the Senate investigating committee is relying on the recommendations made by engineering division. In paragraph 3 of page 3 of the memorandum from the investigating committee the following criticism is made:

"The memorandum for Mr. Bright, deputy commissioner, dated May 7, 1923, by the chief of the timber section I find is an accurate review of the case and contains practically all of the salient matters involved. I do not find in the files, however, any reply to this memorandum or any acknowledgment in any form."

At the outset it would be a physical impossibility for Mr. Bright to have answered this memorandum inasmuch as it never was received by him. The memorandum dated May 7, 1923 never left the timber section. The original of the memorandum is still in that section and in fact was never even signed by the chief of the timber section.

The file of the case in addition to the engineering memorandum dated May 7, 1923 (on which the investigating committee relies), contains valuation reports by the engineering division dated April 3, 1922, and November 23, 1921. A summation of the engineer's arguments is briefly that the engineers are of the opinion that the corporation in depreciating its assets at the rate of 2½ per cent for the years 1907 to 1911, and then increasing the rate to 5 per cent for the years 1912 to 1916 and to 7½ per cent for the years 1917 to 1918 is using a sliding scale of depreciation for the purpose of taking the heavy depreciation deduction in the high tax years; that the arguments advanced by the corporation as to the change in the policy of repairs and the speeding up of the production does not warrant a change in the depreciation rate from 2½ per cent in the earlier years to 7½ per cent in the years 1917 to 1919. The engineer's valuation report dated November 23, 1921, contains a schedule of depreciation rates computed by the engineer for the years up to and including the year 1916 and a second schedule for the years 1917 to 1919. An examination of these schedules indicates that the engineer would allow fairly high rates of depreciation for the years 1917 to 1919 and slightly lesser rates for the years prior to 1917. In the final audit of the case the engineer's rates for the years 1917 to 1919 were accepted by the taxpayer with the exception of the rate with respect to the brick building. The engineer recommended a rate of 2.30 per cent. The taxpayer requested 3 per cent, which rate was allowed in the final audit of the case. At a glance, therefore, it may be seen that there is little or no objection that may be made as to the depreciation rates allowed for the years 1917, 1918, and 1919.

Accordingly the sole question that may be raised to the unit's handling of this case is whether or not surplus at December 31, 1916, should be reduced because of the failure of the corporation to deduct adequate depreciation in prior years. The rates recommended by the engineer for the years prior to 1916 would wipe out the surplus of $238,019.87 on hand at December 31, 1916, and create an operating deficit of some $40,000. The unit maintains that the provisions of A. R. M. 106 are applicable to this case. An interpretation of A. R. M. 106 as rendered by the old committee of appeals and review contain inter alia a statement as to what shall constitute such "affirmative evidence" as will warrant the bureau in reducing the earned surplus of a taxpayer. The rules promulgated by the committee on appeals and review as to what may be considered affirmative evidence are, viz:

"1. The fact that the taxpayer has made no adjustments over a period of years on account of depreciation, either by way of charging ordinary repairs directly to expense and setting up a depreciation reserve against which are properly chargeable all renewals and replacements, or by charging renewals and replacements as well as repairs against gross income.

"2. Where it reasonably appears upon an actual examination of the depreciable assets that the book valuation of such assets is clearly in excess of the actual value at the beginning of the taxable year.

"3. The fact that the taxpayer claims as a deduction in subsequent years depreciation largely in excess of the average claimed prior to the taxable year all other conditions being equal."

It is noted that the third rule mentioned above states if "all other conditions are equal." It was for this reason that the unit did not disturb the surplus as shown on the taxpayer's books at December 31, 1916. The taxpayer has submitted evidence under date of September 30, 1921, showing that its production had increased from 13,000 tons in 1907 to $158,000 in 1919. In addition there was manufactured during the period 1917 to 1919, 37,000 tons of a very fine grade of paper (Dia. C) which required considerable more working over the machinery than the newsprint. The Dia. C production in the period 1917 to 1919 showed a very large increase compared to the production in the years prior to 1916. The repairs as shown on the amended return do not fluctuate to any extent. For example, the repairs made during 1918 are approximately the same as those made in 1916, while the amount of repairs made in 1917 are $20,000 less than the amount expended in 1916. In this connection it should be kept in mind that the labor and other costs in 1918 were two or three times what they were in 1916, so that $2 expended for repairs in 1918 would amount to $1 in 1916. The corporation contends that the labor during the war period was more or less inefficient, and very little time was devoted to making repairs during the period 1917 to 1919. From the information on file it appears that prior to 1916 an adequate repair policy was maintained. A reserve for depreciation of $182,419.58 is shown in the books at December 31, 1916, which represents an accumulated reserve of 10 years. The total depreciable assets on hand at that date amounted to approximately $1,675,000. Included in the latter amount are brick buildings $530,000 and a dam $747,000. The latter assets are slow depreciable assets. When the repair policy of the corporation during these years is taken into consideration along with the above-mentioned reserve of $182,419.58, any reduction to the surplus of $268,019.87 at December 31, 1916, because of inadequate depreciation would appear to be rather arbitrary.

In the engineer's memorandum, dated May 7, 1923 (which, as mentioned before, the investigating committee states is the correct basis on which the case should have been adjusted), there appears an error which distorts the facts of the case. It is stated in last paragraph of page 2 of this memorandum that the accountant employed by the taxpayer has made a reconstruction of the fixed asset account, taking over to the asset side of the balance sheet all of the replacements that had formerly been charged against the reserve for depreciation. An examination of the agent's report and the schedules submitted by the taxpayer's accountant indicate that the total of the assets as at December 31, 1916, as shown by the original balance sheet at that date, agrees exactly with accountant's balance sheet, and in addition that the totals of the assets on accountant's balance sheets as at December 31, 1917, and December 31, 1918, are slightly less than the totals shown by the original balance sheets at those dates. The statement made in the engineer's memorandum that the corporation was granted depreciation on items which had formerly been charged to the depreciation reserve, but which were capitalized and restored to to the asset account can readily be seen from the comparison of the totals of original and amended balance sheets to be absurd and erroneous. What actually happened is that the taxpayer's accountant has segregated the assets and classified those under more appropriate names.

It is evident to anyone making an impartial review of this case that there was friction between the engineering division and audit F section of natural resource division as to who should have jurisdiction in respect to the auditing of the income-tax cases of taxpayers engaged in the paper industry regardless of whether or not such cases involved depletion. From the many caustic comments made by the engineer who handled this case, serious doubt is entertained as to whether he approached the issue with a free and unbiased mind. Furthermore, from the statement made in the last paragraph of page 2 of the memorandum of the Senate investigating committee, in respect to the conference held by the unit, it is also doubtful whether that committee has made an exhaustive examination of the case. The paragraph in question states that although many conferences were referred to, there is a record of only one conference, that of November 26, 1921. The file of the case also contains a record of the conference held on July 18, 1921, which apparently has been overlooked by the investigating committee. The brief submitted under date of September 30, 1921, containing the principal arguments of the taxpayer, was an aftermath of the discussion in conference held on July 18, 1921.

On the basis of the evidence presented by the taxpayer it is evident that the conditions existing in this taxpayer's business were not the same before December 31, 1916, as they were after that date, and there is no affirmative evidence at hand for reducing the surplus as at December 31, 1916, on account of inadequate depreciation prior to that date. It is therefore recommended that the unit's adjustment of the case be upheld.

J. G. BRIGHT,
Deputy Commissioner.

SENATE COMMITTEE INVESTIGATING BUREAU OF INTERNAL REVENUE,
INCOME TAX UNIT,
October 24, 1925.

To: L. C. Manson.
From: L. H. Parker.
Subject: Reply of bureau, Watab Pulp & Paper Co.

We have at hand a memorandum on above case signed by Mr. J. G. Bright, deputy commissioner, dated June 8, 1925. This memorandum was transmitted to the committee by Commissioner Blair on July 9, 1925.

This memorandum upholds the depreciation rates criticized by your engineer in this case of the Watab Pulp & Paper Co.

The object of presenting the original report on this matter was to confirm the two principal points made in the Dill & Collins pulp and paper case, namely, that the system of the bureau puts the authority for depreciation rates up to the auditors and not to the engineers, and that the rates fixed by the auditors are in these instances unreasonably high. The first point is not contested in Mr. Bright's memorandum.

The average rates of depreciation allowed by audit are: 2½ per cent for 1907 to 1912, 5 per cent for 1912 to 1917, and 7½ per cent for 1917 to 1920.

Mr. Bright bases his argument in defense of this case on A. R. M. 106. He states that the following rule has been promulgated by the committee on appeals and reviews:

"The fact that the taxpayer claims as a deduction in subsequent years depreciation largely in excess of the average claimed prior to the taxable year, all other conditions being equal," may be considered as affirmative evidence for reducing surplus.

On the other hand, we quote as follows from the report of Valuation Engineer Robertson, dated April 3, 1922:

"Reference is made to the fifth paragraph of page 1 of the report of this office dated November 23, 1921, wherein attention is called to the fact that the taxpayer uses low rate of depreciation in the earlier life of its properties, then doubles this rate in a later period, and then triples it during the high-tax years.

"This is the outstanding feature of the case, and irrespective of the provisions of A. R. M. 106, on which the taxpayer bases its claims, the action taken is in violation of articles 143, 161, 165, 166, and 839 of Regulations 45."

Let us now quote briefly from the articles of the regulations referred to:

From article 161: "The proper allowance for such depreciation of any property used in the trade or business is that amount which should be set aside for the taxable year in accordance with a consistent plan by which the aggregate of such amounts for the useful life of the property in the business will suffice, with the salvage value, as of March 1, 1913, if acquired by the taxpayer before that date."

From article 165: "The capital sum to be replaced should be charged off over the useful life of the property either in equal annual installments or in accordance with any other recognized trade practice, such as an apportionment of the capital sum over units of production. Whatever plan or method of apportionment is adopted must be reasonable and should be described in the return."

From article 839: "Adjustment in respect of depreciation or depletion in prior years will be made or permitted only upon the basis of affirmative evidence that as at the beginning of the taxable year the amount of depreciation or depletion written off in prior years was insufficient or excessive, as the case may be."

As seen from the above, Mr. Bright's claim under A. R. M. 106 is that there is no affirmative evidence for changing the depreciation rates used by the taxpayer in former years, because the conditions existing in the pre-war and war periods were not the same.

We do not agree with this interpretation of Mr. Bright, because we do not deem it in accordance with common sense or in accordance with the regulations, which should, at least, have as great weight as the ruling which has been quoted and which is based on A. R. M. 106. In a future report on depreciation we shall deal in detail with A. R. M. 106, which contains at least one element which we consider unsound and not in agreement with the intent of the law. Under the point raised by Mr. Bright conditions are not exactly the same in the different years. Conditions are seldom the same in different years, so this argument would always preclude changing depreciation rates.

Depreciation allowances are made for the purpose of returning free from tax the cost or March 1, 1913, value of the property. If a taxpayer claims 2½ per cent depreciation from 1907 to 1912, 5 per cent from 1912 to 1917, and 7½ per cent from 1917 to 1920, regardless of what may have been ruled in published rulings, we deem that this great change in depreciation rates is in itself evidence of an improper method of arriving at depreciation unless it can be shown that there is a reasonable cause for such variation. This reasonable cause is not shown in this case, especially in regard to the change from 2½ to 5 per cent. Some little cause may be claimed for the change from 5 to 7½ per cent rate.

Mr. Bright claims that he never received a protest prepared in the timber section and published in our exhibit in this case. If our report can be construed to infer that he did receive this protest, we wish to withdraw any statement which affirms this, as we have no evidence that Mr. Bright ever received the protest. However, we do believe the protest is sound and pertinent to the discussion of the case.

In conclusion we wish to state that this case of the Watab Pulp & Paper Co. confirms, to our minds, the purpose for which we presented same, namely, that the engineer's determination of depreciation should take precedence over the auditor's. It appears to us that Mr. Bright's defense is based on a technicality in a ruling promulgated by the committee on appeals and review in regard to A. R. M. 106. We believe this A. R. M. 106 to be of itself unsound.

Respectfully submitted.

L. H. PARKER, *Chief Engineer.*

GENERAL REPORT ON TIMBER VALUATION SECTION SUBMITTED BY MR. MANSON

(Page 3263)

MARCH 21, 1925.

Subject: Timber valuation section, organization and administration.

Mr. L. C. MANSON,
Counsel, Senate Committee for Investigating
Bureau of Internal Revenue:

The timber valuation section is a subdivision of the engineering division of the Income Tax Unit.

Organization:
One chief.
One assistant chief.
One engineer for appeals and special work.
Ten regional engineers.
Ten assistant regional engineers.
Clerical force.

WORK OF THE TIMBER VALUATION SECTION

The work of this section will fall into three general classes (named A, B, and C).

(A) Work assigned by office regulations to the timber section for which they are solely responsible.

(1) Valuations of timber property as at dates significant under the law. Including—

(*a*) The determination of quantity and value of timber.

(*b*) Value of plant properties used in the production of timber and manufacture of its by-products including pulp and paper.

(*c*) Value of riparian land and water rights and water-power facilities used in connection with the production of timber and manufactured products and of power-producing enterprises for other industries.

(*d*) Value of cut-over timberland and land under timber.
(*e*) Determination of allowances for losses resultant from destructive agencies.
(*f*) Determination of allowances for depletion and depreciation of property.
(B) Work which the timber valuation section handles on its own initiative and for which responsibility is vague as to finality.
(*a*) Obtaining information from taxpayers' returns and other sources as to persons benefiting by taxpayers' payments of royalties, bonuses, or other emolument, or from purchases of land, timber, etc. Reporting to audit division the names of such beneficiaries and the transactions for the purpose of aiding the audit division in determining if such benefits have been reported as income.
(C) Work in which the timber valuation section acts in an advisory capacity to other sections, units, and officers of the bureau.
(*a*) Consultation and advice to practically all other sections of the engineering division with which timber or the timber industry may have any relative connection.
(*b*) Consultation and advice to solicitor as in cases concerning turpentine production, manufactured wood products, timber industry, etc.
(*c*) Advice occasionally given in cases involved in capital-stock tax and estate tax.

TERRITORY

The timber valuation section has divided the forests of the United States into the following regions:

Region 1. New England.
Region 2 (a). Appalachian hardwoods.
Region 2 (b). Delta (southern) hardwoods.
Region 3. Atlantic coast pine.
Region 4 (a). Southern pine east of Mississippi River.
Region 4 (b) Southern pine west of Mississippi River.
Region 5, 6, and 8. Inland empire and California.
Region 7. Pacific Northwest.
Region 9. Great Lakes forest.
Pulp and paper, all United States.

Each region is in charge of a regional valuation engineer to whom all matters pertaining to that region are assigned.

OFFICE ROUTINE

Original tax returns coming in pass to the files, thence are distributed to the regional engineers in whose regions the taxable property is located. From there to the chief of section and then to audit.

Protest cases are routed from files to regional engineer, to appeals engineer, to chief of section, thence to solicitor.

METHODS

The methods used by the timber valuation section in the handling of its work may be described as follows:

(1) In determining valuations of timber property as at basic dates, fair market value is arrived at along the lines prescribed by Tax Regulations 45, Article 234, i. e.: "The value sought will be the selling price, assuming a transfer between a willing seller and a willing buyer." * * * "The timber in question will be valued on its own merits."

The timber valuation section defines "fair market value of timber property as its cash value in the open market. Analytic appraisal methods, such as present value method, are not used or considered.

The two other major subjects are depletion of timber and depreciation of plant and are thus treated: The life of a timber property is its economic life. If a property is estimated to yield as at a basic date 100,000,000 feet board measure and the yearly cut 10,000,000 feet board measure, the life would be 10 years. Depreciation on plant and equipment is likewise based on the economic life instead of on normal life of constituent items, taking into account, of course, the market value of the plant at the finish of the operation.

The subjects fair market value, depletion, and depreciation will be discussed later in this report.

In connection with the subject of methods I would like to give a short historical sketch of the organization of the timber valuation section.

This section originated early in the year 1919 when timber valuation work was begun by the Bureau of Internal Revenue. From that time to February, 1920, the section devoted most of its time to organizing working forces and compiling basic data. Form T, general forest industries questionnaire, was compiled during this time under the direction of Mr. D. T. Mason, chief of the section, after conferences held with the national associations of the timber industry at several timber regional centers.

The personnel of the section at its beginning was made up of carefully selected forest valuation engineers of high standing in the profession and with A-1 reputations in the industry for recognized ability, without regard as to whether or not the individual had civil-service rating, the object being to procure the best possible men that could be induced by the salaries offered.

Form T, general forest industries questionnaire as first issued, applied to the taxable years prior to 1919. Its purpose was to procure from the taxpayer clear, correct, and complete data as would enable the bureau to deal with each case with the fullest possible set of facts. Also to provide the bureau with means of checking the taxpayer's statements.

The questionnaire is composed of 36 pages containing 291 items, including two for jurat. Items 1 to 11 are under the heading of "General information," relating to names, addresses, dates of organizations, etc.

Items 12 to 14, inclusive, pertain to timberland blocks.

Items 15 to 24, inclusive, specifies maps desired and relative data.

Items 25 to 80 pertain to important purchases and sales of timber or land, or both, involving transactions in tracts of 1,000 acres or over. The information supplied by the taxpayer to this group of questions is used in connection with other relevant data in determining the "fair market value" as of March 1, 1913.

Items 82 to 111 pertain to the status of the property as of March 1, 1913. Data thus supplied forms the basis of computing depletion deductions.

Items 112 to 132 are devoted to purchase of timber or land, or both, for the period of March 1, 1913, to 1918.

Items 133 to 138 are devoted to aggregate sales of timber or land, or both, for each block for each taxable year, March 1, 1913, to 1918.

Items 139 to 158 pertain to losses of timber sustained since March 1, 1913, due to destructive agencies.

Items 159 to 166 seek information on measures taken by taxpayer to protect his timber from damage by fire, insects, etc., money expended for such protective work each year, 1910 to 1918, data on growth and its effect, if any, on increasing the quantity of timber.

Item 167 pertains to valuation of timber by species or groups of species when unit depletion charge based on the average value of all species present is inequitable.

Items 168 to 186 embrace timber-cutting records for the taxable years 1910 to 1918, inclusive.

Items 187 to 199 pertain to depletion charged for the taxable years 1913 to 1918, inclusive.

Items 200 to 210 call for an inventory of physical property as the means of computing depreciation.

Item 211 requests data on additional timber in block, or adjacent to, and likely to be secured by taxpayer.

Items 212 to 226 relate to manufacturing operations where the raw material is obtained from the woods. Data requested is for the years 1912 to 1918, inclusive.

Items 227 to 241 is the same except it applies to finished products handled.

For pulp and paper a separate questionnaire, form T-P is used. This subject will be discussed later.

Item 241 is for lumber inventory of amounts on hand the last day of each taxable year 1912 to 1918, inclusive, for each manufacturing operation.

Items 242 to 252 relate to operating features of sawmill plant, as number of shifts, average cut per shift, average hours per shift, and shifts per year for years 1912 to 1918, inclusive, and character of mill plant in 1918, giving number and kinds of machines, capacity, etc.

Items 253 to 287 call for information on profit or loss from sale of capital assets with respect to each transaction involving the sale of timber or land or both during the period March 1, 1913, to the end of 1918.

Item 288 calls for list of litigations between January 1, 1911, and January 1, 1915, as involve the value of the property.

Item 289 requests report on transactions with affiliated interests.

Items 290 and 291 provide for jurat, and following this are pages 29 to 36, inclusive, with quotations from Regulations 45.

This Form T is that specified in article 233 of Regulations 45. A revised form and supplement to it was issued to serve for the taxable years 1919 and following. This letter is the Form T specified in article 233, Regulations 62, and article 235, Regulations 65. It is named "Forest industries schedule" and is composed of 8 pages containing 39 questions and jurat.

Form T-P, specal forest industries questionnaire for the pulp and paper industry. It is composed of 16 pages containing 226 items, including 2 for jurat. This form is issued primarily for the industry above named, but where the taxpayer is an owner, lessee, or lessor of timberlands of standing timber, whether operated as a feeder to his manufacturing enterprise or not, is requred to use Form T in conjunction with Form T-P.

DETERMINATION OF FAIR MARKET VALUE OF TIMBER—DETERMINATION OF QUANTITY OF TIMBER

For the purpose of timber valuation, these two subjects are mutually dependent and establish the basis of determining allowances for depletion and depreciation.

Regarding the first named, article 234, Regulations 45 and subsequent regulations, provide the basis for determining fair market value which, if referred to, will be seen to require the use of many factors in order to arrive at an equitable result. Some of the most important are—

(*a*) Character and quality of timber as determined by species, age, size, condition, etc.

(*b*) Quantity of timber per acre and total.

(*c*) Location with reference to other timber.

(*d*) Location with reference to distance from a common carrier.

(*e*) Topography and other features of the ground affecting handling and transporting.

(*f*) Freight rates by common carrier to important markets.

The forest industries questionnaire amply serves to obtain this information.

Regarding the determination of the quantity of timber, Regulations 45, artice 235, provides that taxpayer claiming a deduction for depletion is required to estimate the total units of timber known or believed to have existed on the ground on March 1, 1913, or date of acquisition.

This estimate shall state as nearly as possible the number of units which would have been found present by careful estimate on the specified data with the object of determining 100 per cent of the quantity of timber which the area would have produced on that date if all the merchantable timber had been cut and utilized.

This 100 per cent estimate when given for March 1, 1913, or other retrospective date, is subject to rigid inquiry in order to prove the figures. There are cases on record where the difference in quantity between those given by the purchaser and seller varied as much as 100 per cent.

There is ample opportunity for vast differences in estimates. A source of great difference lies in the degree of accuracy used by the cruiser, which may vary from the rapid, inexpensive preliminary to the detailed, exhaustive total tree count. Where the stand is composed of several species greater differences are more likely than with timber of one or a few species.

Another source of difference is the practice of the industry in computing tree contents by means of log rules. The common unit of measure is feet board measure according to a particular log rule, which is a tabular scale showing the amount of lumber in feet board measure which can be sawed from logs of given lengths and diameters, with allowances made for waste, loss by saw kerf, and defects. There are more than 40 such rules in use in America, each different, and many giving widely different results for the same size log.

The cause of so many rules coming into use is due mainly to the methods of scaling timber in the woods in accordance with the practices of utilization in different localities. Also, to the species and characteristics of the timber growing in those localities. Some log rules are sanctioned by State law, others adopted by various associations in the timber industry. The most commonly used rules are the following:

Doyle rule.—The statute rule of Louisiana, Florida, and Arkansas. This rule is more generally employed throughout the country than any other.

Scribner rule.—Adopted by Minnesota, Idaho, Wisconsin, and West Virginia. This is the oldest rule in general use; originated prior to 1846.

Spaulding rule.—Adopted by California in 1878.

Blodgett rule.—Used in New Hampshire and Vermont and to some extent in Maine.

Drew rule.—Adopted by Washington State. Sanctioned by the Puget Sound Timbermen's Association.

Scribner rule (Decimal C).—Adopted by United States Forest Service.

Doyle-Scribner combination rule.—Adopted by the National Hardwood Lumber Association.

Columbia River rule.—Used largely in the Pacific Northwest.

Cord measure.—Pulp companies generally use this unit of measure for reporting their timber. It is subject to inconsistencies due to different methods employed in various localities. The amount of board feet equivalent to a cord may vary from 400 to 700.

As to log rules, the majority of the taxpayers use the Doyle and Scribner rules. The Spaulding and Columbia River rules are used to a large extent by Pacific Northwest taxpayers. The Blodgett and Maine rules in Maine, New Hampshire, and Vermont.

The difference between the contents by log scale and mill tally of a log after being sawed into lumber is generally overrun, although some log rules for certain size logs will just hold out or show underrun.

It is manifest that the timber valuation section can not cruise all of the timber in the United States. Field checks could be made when warranted, but this method would serve only a minority of the cases in hand. It must therefore rely on careful analysis of the data furnished by the taxpayer in determining the 100 per cent estimate as of a basic date.

Form T: General forest industries questionnaire, by the manner of its cross-questioning, provides a good means of eliciting data to accomplish a reasonably good check. Much, however, depends upon the valuation engineer of the region in which the property is located. Each regional engineer in the timber section is regarded as a specialist on all matters pertaining to the industry in his region, and his knowledge of conditions and judgment exercised in the analysis and adjustment of all cases handled by him are solely relied upon. For example:

A means of check upon the quantity of timber reported as cut during any year is found in the questionnaire, page 23. This applies in the case of a taxpayer who saws his logs into lumber. Here the logs cut during the year are stated in log scale measure and the lumber sawed during same period in mill tally. The difference between the two will denote either overrun or underrun, and constitute a check for the regional engineer, who must determine the correctness or reasonableness of the figures. This involves his knowledge of the character of the timber stands in his region, the log rules used, and the usual percentage of overrun they produce after the run through the sawmill; the types of sawmill machinery, particularly saws, whether circular or band saws; and the operating methods and character in general of the operator. Equipped with this knowledge, he is relied upon to judge if the figures reported by the taxpayer are true and correct. This is especially important in checking depletion.

The timber industry is one subject to constant changes by virtue of the nature of the forest. Trees regarded as too young to be classed as merchantable or species having little or no demand in the market at the time the cruise or estimate was made may later add materially to the yield.

Most estimates, I am advised, are conservative, showing after a series of years of cutting a surplus sufficient to increase the life of the property. On the other hand, the section has cases on record where the taxpayer was actually defrauded by finding afterwards considerably less acreage and timber than represented to him at the time of purchase.

DEPRECIATION OF PLANT AND EQUIPMENT

As previously stated, the timber valuation section treats depreciation on the basis of the economic life of the timber property, taking into account the salvage value at the finish of the operation. Their method is to determine the value as at the basic date, fix a salvage value, and write off the difference by straight-line method over the term of years represented by the economic life.

The salvage value fixed is generally less than 15 per cent and in the majority of cases about 5 per cent. A timber property with a 15-year life, for example, has at its close little left of its plant and equipment exceeding this life to any appreciable amount unless long-life replacements were added in intervening years. The greater part of the cost of the plant is in labor, which is a consumable item. Another factor in fixing the residual value of the plant and equipment is its worth if offered for sale in the open market. Generally, on account of the isolated location of timber plants, only such items as can be dismantled and moved to another location without too great expense have any significant recoverable value. The remainder may be considered as scrap. Again, considering obsolescence and the uncertainties of the state of the market for secondhand machinery and equipment, the amount which may be realized from a sale is likely to be low unless unusual contingencies should favor.

While the straight-line method of figuring depreciation rates is the practice favored by the section, there is no office rule binding to this method. It is more frequently employed than any other, but the section assents to any proper method submitted by the taxpayer if such method is regarded by the section as sound and applicable to the individual case; one, for example, depreciation on the basis of depletion sustained. This method is sound if safeguarded by a complete check of all basic and contributing factors.

OFFICE REGULATIONS

Reference is invited to Income Tax Unit Office Order No. 715, dated February 21, 1923, page 12, of Item H, reading: "The timber valuation section, which will determine the value of timber property as of dates significant under the law, and reasonable amounts allowable as deduction on account of depletion."

Beyond this there appears to exist no written specific instructions relating to the duties and responsibilities of the timber valuation section. Whatever instructions supplemented this are believed to have been verbal, until the issuance of memorandum from chief of timber section to Mr. Greenidge, head of engineering division, dated September 20, 1923, which is a confirmation of instructions governing the functions of the section received at conference the day before. In this the functions of the section are described as determinations of quantity and value of timber, value of plant properties, water-power facilities, pulp and paper manufacturing properties, cut-over timberland and land under timber, losses from destructive agencies, depreciation of plants, analysis of inventory values of logs and lumber, with recommendations to audit sections and technical advice to audit section on questions affecting the timber industry.

This is the only statement discovered wherein the functions of the timber section are shown in any detail. The fact that there is nothing to show that it was received and approved by the person to whom it is addressed by written acknowledgement leaves it without substantiation.

The next following relevant communication is memorandum of chief of timber section to Mr. Greenidge, dated February 29, 1924. The purpose of this memorandum is to bring to the attention of the head of the engineering division the fact that there is divided responsibility in the unit in the work of determining income tax status. The salient points brought out are:

(1) That confusion exists in the minds of the engineers of the timber section as to where their functions and responsibilities end.

(2) That present practices divide the responsibility between the audit and timber sections in performing the following work:

(*a*) The valuation and depreciation of physical properties for both invested capital and income.

(*b*) The determination of profit and loss from sale of capital assets involving valuation and depreciation.

(c) Losses sustained through casualty and obsolescence.
(d) Valuing of inventories of forest products.

(3) That this divided responsibility has caused inconsistencies and in some cases actual loss to the Government and altogether affords an ample and just reason for taxpayers to criticize the unit for its procedure.

(4) That by present practice it is possible and has actually happened that a taxpayer will hold a conference with the timber section regarding physical property valuation or depreciation and at a later date take up the same matter with the audit section. In exceptional cases the engineers and auditors may be in the same conference with a taxpayer and be of entirely different opinions as to the methods which should apply. This situation is evidence to the taxpayer that the unit is of divided mind on interpretation of authorized duties.

(5) That a situation equally serious is created by the practice of auditors questioning the recommendations of the engineers on matters pertaining to valuations, depreciation rates, and other constituent items, and, disregarding the engineer, base their audit on a different premise.

(6) That this last practice is equally harmful when a taxpayer finds that the figures on his A-2 letter do not agree with the valuation report figures, which occurs when the A-2 letter reflects the auditor's basis of computation and the valuation report, the engineer's. Particularly so when the figures in the valuation report had been agreed upon in conference with the timber section.

At this point the memorandum assumes that it has been clearly shown that the handling of the points mentioned should be assigned to the organization best qualified to perform the work, and puts the question, which engineers or audit? Answering in favor of itself, it then gives a full statement of reasons for its contention, which may be summarized and briefly stated as: "All of the points at issue are purely of engineering nature and should be handled by the engineers of the timber section because of the diverse character of the different timber regions and the individual problems therein, which can best be dealt with by the engineers assigned to the particular regions, concerning which they are most familiar."

The memorandum then recommends that decisions made by the engineering division be accepted for the purpose of audit with the provision that the audit section, where it disagrees with the recommendation of the engineering division, shall have the right to take up the matter with the proper person in the engineering division, in which event if the engineer does not concur in the changes suggested, by the auditor, the decision of the engineer shall prevail.

So far as I have been able to find, there have been no orders issued or any action taken in definite written form toward adjusting the matters complained of, and the status today is the same. Some informal improvements have been effected since, coming as result of better understanding between individuals, especially with revenue agents and field auditors, for the common good.

It is not intended by this to charge that the audit division at all times ignores the engineering division. On the contrary, there is a large amount of cooperation and coordination of work between the two organizations, but this is mainly due to the former associations of the individuals when the national resources division was in force. Now as before, the auditors who were in that division will seek the advice and approval of the timber section on matters of purely engineering nature. However, this practice is not general and regular. Auditors now handling timber cases who before the abolishment of the natural resources division were attached to some other audit section and are not acquainted with the functions of the timber section as are the others mentioned, are consequently less inclined to attach the same importance to the engineer's recommendations, hence are more likely to look upon the work of determining depreciation, etc., as within their sphere of duties.

From the foregoing it is plain that some reform or correction is vitally necessary to the present practices in the unit.

SCOPE OF TIMBER VALUATION SECTION'S JURISDICTION OVER ENTERPRISES OF THE TIMBER INDUSTRY

May be grouped under the two headings—depletion and depreciation.

(1) *Depletion.*—All timber depletable, irrespective of the products manufactured therefrom. This includes all operations where timber is cut and

the raw product utilized. In some cases sold in a log market, in others the timber is manufactured into lumber, sash and doors, pulp and paper, matches (flitches only), etc., or all enterprises where the raw material goes on through to manufactured products within the control of the owner of the depletable timber.

(2) *Depreciation.*—(*a*) All manufactures of lumber and any wood products from raw material including any subsidiary remanufacturing. Raw material is here defined as logs. No exception is made whether the logs are purchased in a log market or come direct from the woods.

(*b*) All manufactures of pulp and paper and kindred products, such as beaverboard, boxboard, etc.

(*c*) Plants used in connection with the production of by-products, such as (1) turpentine and resin; (2) kilns for extracting chemicals from wood and bark. The equipment used in the refinement of the chemicals, such as wood alcohol, formaldehyde, acetate of lime, etc., and also tannic acid are not handled by the timber section, this class of equipment being handled by the audit sections concerned.

In the case of match manufacture, it is followed to the point where the logs are converted into flitches. From thence on it is in the hands of the audit section.

All enterprises producing refined wood products from a manufactured or partly manufactured stock, as lumber or cordwood in which depletion is not concerned, are classed as industrials and responsibility is assumed by some other section.

The timber section's jurisdiction extends over riparian land and water rights, included in assets of taxpayers owning depletable property; hydroelectric and hydraulic power-producing enterprises as part of the physical properties of wood pulp and paper manufacturers, also of textile, public utility, and other manufacturing enterprises not connected with timber production or wood products manufacture.

An estimate made by the timber section of approximate value of assets as of March 1, 1913, owned by American taxpayers shows the following:

Timber—1,560,000,000,000 board feet	$4,700,000,000
Timbered land—375,000,000 acres	1,125,000,000
Physical property, plants, private railroads, etc., used in the lumber industry	1,000,000,000
Miscellaneous cut-over lands, etc	600,000,000
Pulp and paper and allied industry, physical property, water power, etc	650,000,000
Timberlands in foreign countries owned by American taxpayers—150,000,000,000 feet	150,000,000
Total value	8,225,000,000

The timberlands in foreign countries are nearly all in British Columbia.

YEARLY PRODUCTION REPORT

Cases on hand Feb. 29, 1924, for the years 1917 to 1922, inclusive	2,479
Cases received to Feb. 27, 1925, for the years 1917 to 1922, inclusive	6,177
Total cases on hand Feb. 27, 1925	8,656
Total cases sent out during year ended Feb. 27, 1925	7,644
Balance on hand Feb. 27, 1925	1,012

Of these 1,012 cases on hand, approximately 269, or 27 per cent, are protest cases, the remainder being original cases. Of the 7,644 cases sent out during the year, 1,990, or 35 per cent, were protest cases.

Respectfully submitted.

C. D. VASSAR, *Investigating Engineer.*

Approved:

L. H. Parker, *Chief Engineer.*

Taxpayer: Westinghouse Air Brake Co.
Address: Pittsburgh, Pa.
Status of case: Year 1917 closed. Years 1918 and 1919 not closed. Case has been audited, however, for these years and reflects an overassessment of $97,679.21 for 1918 and additional tax in the amount of $80,260.52 for 1919. No waiver on file for 1917. The waiver on file for 1918 will expire as to original return, July 15, 1925, and as to amended return, March 10, 1926. Waiver for year 1919 on file.
Features examined: The criticism of the Senate committee investigating the Income Tax Unit.

At a hearing of the Senate investigating committee, Mr. Manson, counsel for the committee, made the following statement in regard to the above case:

"The bureau, in examining their claim for amortization, determined that the houses were worth more at the close of the war than they cost; in other words, that the cost of reproduction after the war was greater than it cost them to build them. So there was no claim there for a loss of value because of loss in cost of reproduction, but a claim was allowed for amortization based upon this theory; the houses had no greater extent of vacancy than could normally be expected, but the company had difficulty in collecting their rents; so the amortization was determined by comparing the rents collected during the postwar period with the rents they collected during the war period."

Mr. L. H. Parker, chief engineer for the committee, submitted a report discussing the amortization allowance in the above case. The major criticisms are stated as follows:

"1. In establishing the 'value in use' of facilities retained by the taxpayer the committee engineers contend that the Income Tax Unit did not comply with the opinion of the Solicitor of Internal Revenue relating to the amortization claim of the J. I. Case Threshing Machine Co., wherein it was held that the 'value in use' factors should be determined for specific facilities.

"2. In respect to the 'value in use' of certain dwelling houses, it is stated that the Income Tax Unit erred in determining the value of postwar use upon the basis of a comparison of rentals received with rental capacity.

"3. The committee engineers further protest the determination of 'value in use' ascertained by comparing production for the peak six months of the year 1918 with average annual production during the years 1921, 1922, and 1923."

The criticism made in the Senate testimony and also in Mr. Parker's report as to the amortization of housing facilities and the value in use of certain dwelling houses, is the outstanding feature in the criticism. It is submitted that the amortization engineer did not determine the value of postwar use upon the basis of a comparison of rentals received with rental capacity. However, the audit section of the Income Tax Unit in auditing the case, saw that the company was not entitled to claim amortization on its housing facilities, because the property was sold by the parent company on July 1, 1919, to its subsidiary for stock, receiving a consideration equal to the cost of the property. Consequently, the allowance for amortization on the dwelling houses was eliminated in the audit of the case for 1918 and 1919. This letter, fully prepared, disallowing amortization on dwelling houses, was with the case while in the Senate committee's hands, so that the engineer's action was not sustained by the unit and further the criticism of the Senate's engineer is unjustified, since the Income Tax Unit did not make the allowance which is the subject of the criticism.

The criticism that in establishing value in use the Income Tax Unit has not complied with the opinion of the Solicitor rendered in the amortization claim of the J. I. Case Threshing Machine Co., wherein it is held that value in use should be determined for specific factors, is answered by stating that the problem of the amortization engineers would be very much simplified, if the value in use could be segregated and determined for each specific facility. The taxpayers, in a majority of cases are unable to show a segregation or record of the specific facilities, consequently, it is necessary to group them. In this particular instance, some 834 separate property items were involved and the specific facilities which were to make up a production unit, were grouped, following the long established practice of the appraisal unit in this respect. It does not appear that the value in use can be determined for each specific facility and consequently, the criticism of the engineer for the Senate committee in this respect is illogical and can not be agreed with.

With respect to the protest that value in use was incorrectly ascertained by comparing production for the peak six months of 1918 with the average annual production during the years 1920, 1921, 1922, and 1923, the engineer for the Senate committee has worked out four different bases for determining value in use and it is believed that an analysis of these four different methods will sufficiently establish that the method followed by the unit is not only the most logical one, but the only one that can be defended under the regulations and rulings by which the unit is bound.

The first method makes a comparison of the average production statistics for the years 1921, 1922, and 1923, with the production statistics for the peak six months in 1918.

This method is practically the same as the one followed by the unit and the net result is practically the same. Objection, however, was made by the Senate engineer, because the same six-months' period in 1918 was not used as the peak period for all the departments. The answer is obvious. The peak period in various departments can not be the same for the reason that the facilities were not installed at the same time, nor reached their peak production at exactly the same time.

The second method is a comparison of average production figures for 1921, 1922, and 1923, with the average figures for the war period, this period extending from April, 1917 through February, 1919, because February 28, 1919 has been considered as the date of cessation of war activity.

This method is obviously wrong, since war facilities on which amortization might be allowed, must have been installed after April 6, 1917. Consequently, to make a comparison prior to the high production period in 1918, would be unfair, for the reason that until these plants were operating at their peak production, no basis existed for comparison.

The third method is a comparison of the average production statistics for the years 1919 to 1923, inclusive, with the average production of the war period.

This method has many things to recommend it. However, since by proclamation the war was declared to have ended March 1, 1921, it is evident that to use the years 1919 and 1920 would bring in elements which should not be included to arrive at a comparison with post-war condition. The years 1921, 1922, and 1923 have been consequently held by the unit to be the postwar years for purposes of comparison.

The fourth method advanced is a comparison of production figures for the peak postwar year with the production figures for the year 1918. This method is open to the criticism that a cycle of years must be taken in order to arrive at a comparison, since the production in any business is not stationary. A sufficient number of postwar years must be used in order to comprehend the low as well as the high point in production during a particular cycle.

To summarize, then, the conclusions reached as the result of a study in this case are that while there might have been some justification for criticizing the allowance of amortization on housing facilities upon the basis of a comparison of rentals received with rental capacity, since said allowance has not been made to the taxpayer and there never was any intention to make same by the unit, no cause for criticism exists. As to the criticism of establishing value in use for facilities and the ascertainments of same by comparing production for the six months' period in the year 1918 with the average annual production during the years 1921, 1922, and 1923, the method followed by the unit in this case is sustained by the law, regulations and rulings, consistent practice, and practical limitation.

For the above reasons no adjustment of this case for the years 1918 and 1919 is recommended, because of the criticisms made by counsel for the Senate committee investigating the Income Tax Unit.

J. G. BRIGHT,
Deputy Commissioner.

NOVEMBER 6, 1925.

To: Mr. L. C. Manson, general counsel.
From: Mr. L. H. Parker, chief engineer.
Subject: Reply of the bureau in re Westinghouse Air Brake Co.

We have at hand a memorandum signed by Deputy Commissioner J. G. Bright, defending the action of the unit in the allowance for amortization in the Westinghouse air-brake case.

As stated in Mr. Bright's memorandum, "the outstanding feature in the criticism" made by the Senate committee's engineers in this case was on the basis upon which amortization was allowed on certain houses. This basis may be stated as folows:

The total number of rental months for the houses is found by multiplying the number of houses by 36 (the number of months in the years 1921, 1922, and 1923). The normal occupancy of the houses is then taken at 90 per cent. The total number of rental months is therefore reduced by 10 per cent to give the expected rental months for 1921, 1922, and 1923. This figure is then divided by the actual rental months collected to give the value in use.

The taxpayer has admitted on pages 68 and 69 of his brief that the houses were occupied almost continuously during the postwar period, but that the company was unable to collect the rent. The basis as set up by the taxpayer, then, and as used by the amortization engineer is based on a determination of present use by means of the ratio of rents collected to rents normally expected instead of the usual basis of actual occupancy to normal occupancy.

When your engineers presented this case we were primarily investigating the methods of the engineering division, appraisal section, and we desired to present for consideration of the committee and the bureau's representatives the basis on which amortization had been allowed by the engineers in this case as above described.

We still do not know after reading the deputy commissioner's reply whether or not this basis of expected and actual rents is a method acceptable to the bureau. We had hoped a definite answer to this question.

Mr. Bright's answer in the case on this outstanding feature is that the audit division did not allow the amortization as set up for these house by the engineering division. He states that a letter was in the files showing this when the case was in the hands of the Senate committee's engineers, and that our criticism is unjustified because the audit division disallowed the amortization on houses, not on the basis of expected rentals, but on another basis, that of sale of the property on July 1, 1919, for a consideration equal to the cost of the property.

Now, on this matter of the audit letter disallowing amortization, which Mr. Bright states was in the file, your engineers did not observe this letter, and would have been glad to have given the proper recognition to the soundness of this denial by audit. This would not have changed, however, our criticism of the appraisal section, and it moreover raises the following questions:

1. Our report on this case was dated April 23, 1925, yet in May, 1925, the appraisal section notified us that under Serial No. 2684 the Westinghouse Air Brake Co. had been allowed $1,471,369.24. Now, this amount includes the amortization on houses. Then does the audit division have the power to change an engineering determination signed by three engineers by a simple letter without first consulting the engineering division? Mr. Bright's reply makes this appear to be answered in the affirmative, but if it is so, we question the propriety of the proceedure.

2. If audit changes the amortization allowed by the engineers on a basic principle, if the engineers are not notified, how can they help making the same mistake again?

3. If the same mistake is made again, how can we be sure audit will catch it if it happens to go to a less competent auditor?

We repeat that is this case the question of whether or not value in use of houses should be based on actual occupancy or on the basis of rents collected is still unanswered by the bureau.

The next point raised by Mr. Bright is in defense of the method of grouping facilities together and then arriving at a per cent in use for the whole group rather than examining each facility as required by the solicitor's ruling in the case of the J. I. Case Threshing Machine Co. Mr. Bright states as follows:

"The taxpayer, in a majority of cases, is unable to show a segregation or record of the specific facilities, consequently, it is necessary to group them."

We can not give serious consideration to this statement for the following reasons:

1. If the taxpayer can not show a record of the specific facilities, how can the cost of these facilities be determined, as is absolutely necessary before the loss on same can be computed?

2. If the taxpayer can not show a record of the specific facilities, how can the dates of purchase be determined, as is absolutely necessary in order to see if amortization is allowable as they must be acquired during the war period?

3. If the taxpayer can not show a record of the specific facilities, how does Mr. Bright know that there were "864 separate property items" in this case?

Mr. Bright also defends the grouping of facilities on the basis of its being "the long-established practice of the appraisal unit." This argument has no weight with us if the "long-established practice" is wrong, and in this case it had also been condemned by the solicitor's ruling of August, 1923, while the engineer's report in this case is dated March 1, 1924.

Mr. Bright's letter also discusses four possible methods of arriving at amortization in this case as submitted by your engineers. We did not recommend for special consideration or approval any of these methods; we simply presented them to show the need of a standard method if a constant result was to be expected. Our investigation of the amortization section has revealed the fact that there appears to be no standard method but that practically every engineer has a system of his own. As our final report on amortization will contain our views on amortization methods in full, it would be a duplication to present them here.

In closing we desire to state that our report on this case was intended as a criticism of the methods of the appraisal section (formerly amortization section), and we were not primarily concerned with the action by audit. If the auditors have the power to overrule the engineer's reports without notifying the engineering division we would strongly condemn this system. We consider that our criticism in this case should stand as made.

Respectfully submitted.

L. H. PARKER, *Chief Engineer.*

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, June 8, 1925.

Hon. JAMES COUZENS,
Chairman Special Senate Investigating Committee,
United States Senate.

MY DEAR SENATOR: Reference is made to the case of the Northwest Steel Co. presented before your committee on December 9 and 10, 1924, in which certain questions were raised concerning the amortization allowance to this company.

Subsequent to the presentation of the case this bureau had a further investigation made of the amortization allowance, and it appears therefrom that there is no evidence of fraud; also the reinvestigation disclosed that the amortization allowance was not excessive.

Since the rights of the Government have not been prejudiced by the action in this case, it is the opinion of the bureau that the case should not be reopened.

It will be appreciated if this letter is made a part of the official record of the special investigating committee.

Sincerely yours,

D. H. BLAIR, *Commissioner.*

SENATE COMMITTEE INVESTIGATING BUREAU OF INTERNAL REVENUE,
INCOME TAX UNIT,
September 8, 1925.

To: Mr. L. C. Manson, general counsel.
From: Mr. R. C. Thomas, investigating engineer.
Subject: Reply to communication of Mr. D. H. Blair, Commissioner of Internal Revenue, to the Hon. James Couzens, dated July 11, 1925. Case of Northwest Steel Co.

During the hearings before the Senate committee investigating the Bureau of Internal Revenue, the case of the Northwest Steel Co. was presented December 9, 10, and 30, 1924. In the discussion of this case it developed that certain bonuses had been paid to officials of the taxpayer's company, and it was supposed that these bonuses in some way entered into the sale of the taxpayer's assets to a partnership made up of former employees of the taxpayer.

At one of these hearings Senator Couzens, chairman of the investigating committee, requested the unit to furnish certain information in connection with the bonuses and amortization allowances to this taxpayer, and addressed a letter on this subject to Commissioner Blair under date of June 18, 1925.

which letter was in reply to a communication from Commissioner Blair dated June 8, 1925.

In this letter of June 18, Senator Couzens requested Mr. Blair to furnish the committee a copy of the revenue agent's report. Also his (Mr. Blair's) conclusions in the matter. On July 11, 1925, Mr. Blair replied to Senator Couzens, stating that—

"It was disclosed by the recent revenue agent's report that the bonuses of certain employees entered on the books of the company were canceled prior to the sale by the company of its plant. Consequently the bonuses were not included in the income of these employees nor did they constitute a part consideration for the sale of the plant of the company."

A literal construction of this quotation does not agree entirely with the statement of the amortization engineer who compiled the report in which amortization was allowed in the sum of $615,762.46, on page 7 of the engineer's report of Mr. Carlson. Mr. Carlson gives numerous advantages enjoyed by the taxpayer by reason of the above-mentioned sale. Among these is the following:

"The cancellation of a bonus liability that would eventually amount to over $500,000."

On page 6 of this same report the following appears:

"In the fifth place, one of the largest considerations that does not appear in the sale, was the cancellation of certain bonus obligations. Messrs. Cullers & Banks, in the early stages of the shipbuilding work, had been guaranteed certain bonus payments based on tonnage. The business of the taxpayer expanded to such an extent, however, that these bonuses grew to an enormous proportion. For 1917 and 1918 Mr. Cullers received $106,025.71 and Mr. Banks $70,683.81. When the first sale of the part of the plant was made to the partnership, of which these men were members, they had bonus credits accrued to them of $189,343.62 and $123,277.42, respectively, or a total of $312,621.04, with some $200,000 more coming, had the taxpayer completed the shipbuilding instead of turning it over to the partnership. *All of this bonus was canceled as one of the considerations at the time of purchase. This canceled bonus is herein considered as a part of the return received from the sale.*"

From the above it is evident that either Mr. Blair or Mr. Carlson is in error. It is the writer's opinion that Mr. Carlson was in a much more advantageous position of determining this question than was Mr. Blair, as Mr. Carlson made a detailed study of the whole case, and inasmuch as the sale of the property by the taxpayer to the partnership was so questionable as to warrant its reference to the fraud section and the solicitor's office, it would appear that Mr. Carlson had the advantage of having been in personal contact with all of the details surrounding the case.

In Mr. Blair's letter to Senator Couzens dated July 11, 1925, he further states:

"This information shows that in the amortization allowance granted the company the sale price of the plant was overstated because of the inclusion of these bonuses, and that, consequently, the company was entitled to a greater amortization allowance than was actually allowed by the bureau."

If Mr. Carlson is correct in his contention as quoted from his report, it is very evident that Mr. Blair is in error in his conclusions. Mr. Blair further states in his letter:

"The report of the revenue agent in this case was not entirely complete on one point, and he has been instructed to make a supplemental report. When the supplemental report is received I shall be glad to transmit it with the original report to you."

In this connection the writer desires to state that he has made a thorough search for these reports and can find no evidence of the fact that they were ever sent to Senator Couzens.

In summation of the above, it would seem that Mr. Blair's reply to Senator Couzens is simply a brief statement of conclusions which are not necessarily based on facts, and is not enough in detail to give the information which it is believed the Senator desired. The writer can find nothing in Mr. Blair's letter, together with the engineer's report above referred to, to substantiate the statement that the axpayer was entitled to a greater amortization allowance than was actually allowed by the bureau. Neither is there anything to substantiate the statement that the bonusues did not constitute a part consideration for the sale of the plant by the taxpayer.

It is frankly admitted by Mr. Blair that the bonuses were entered on the books of the taxpayer, we also know that at least some of the bonuses were actually paid, and we still question the reasonableness of two individuals forgiving a company over $312,000 of an admitted indebtedness without any consideration.

R. C. THOMAS,
Investigating Engineer.

Approved:

L. H. PARKER, *Chief Engineer.*

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, July 10, 1925.

Hon JAMES COUZENS,
Chairman Senate Investigating Committee,
United States Senate.

MY DEAR SENATOR: I am attaching hereto memoranda which have been prepared in reply to the criticisms of the Senate investigating committee relative to 17 amortization cases settled by the production committee.

Will you be good enough to have these memoranda inserted in the official records of the investigating committee?

Sincerely yours,

D. H. BLAIR, *Commissioner.*

JULY 8, 1925.

Memorandum: In re criticism of amortization allowances recommended by the production committee of the engineering division.

Mr. R. C. Thomas, investigating engineer, has severely criticized the production committee of the engineering division for its action with regard to the amortization claims on 17 specific cases, first from a general standpoint and second through specific reference to each case.

To some extent Mr. Thomas's criticisms are based on lack of knowledge of the functions of the production committee and of its method of action, and to a very large extent his criticisms are based on assumptions of fact which are not borne out by the records.

First of all, the cases referred to by Mr. Thomas were all classified as office determinations; that is, cases where the amount of tax and the principles involved did not warrant a field investigation. The facts are that the production committee carefully examined the files of all of these cases, and wherever any doubt existed the appraisal engineer assigned to the production committee was consulted. Further, this appraisal engineer approved any of the actions taken by other members of the production committee before the case was finally passed upon. When a sufficient number of cases had been decided a stenographer was called in and a transmittal form filled out in lieu of the report form used by the appraisal section.

General criticisms of the work of the production committee on this class of cases have been made as follows:

"1. That the committee allowed amortization in direct opposition to the recommendation of the appraisal engineers who had made a careful study of the cases after first having made a thorough investigation in the field. That these allowances were made by the committee without any apparent explanation."

The above conclusion is not justified by the facts. Whenever a prior report of an engineer was disregarded it was generally because of additional information furnished by the taxpayer which warranted the change in the amortization allowance. No lengthy discussion of the reasons for allowing the taxpayers' claims was made because expeditious action was desired, but a study of the information in each case reveals that ample information was present to justify the allowance made.

"2. That this committee allowed amortizatoin on facilities which, according to the engineer's report, was 100 per cent in use during the post-war period. This determination of value in use by the engineer having been made only after a thorough investigation and a thorough survey of the facilities in question at the taxpayer's plant by the engineers."

In many of the cases criticized by Mr. Thomas the allowances made by the production committee were based on postwar replacement costs, whereas the original amortization claims made by the taxpayers were based on value in use and the engineer's report made accordingly. Subsequently to the making of the engineer's report taxpayers changed the basis of their claims from that of value in use to that of postwar replacement costs. In other cases where there was no change in the basis of the taxpayers' claims the action of the production committee was taken several years subsequently to the appraisal engineer's report and in the interim there was ample opportunity for considerable change in the value in use of the facilities.

"3. That this committee allowed amortization without first having either a field investigation or report or even an office report submitted by an appraisal engineer, and so far as the records show based the allowance solely upon the 'say so' of the taxpayer and without any evidence to substantiate its claim."

As formerly mentioned, all these cases were given a through office determination and were passed on by an appraisal engineer.

"4. That this committee, without explanation and without apparent justification, overruled both the recommendations of the appraisal engineers and the action of the conference committees, which committees meet for the specific purpose of determining amortization questions, and before which both the taxpayer's and unit's representatives were present to present their respective sides of the cases and to thoroughly discuss the merits of same."

"5. That this committee allowed amortization in cases where the data submitted by the taxpayer was not in accordance with the requirements of the unit. In many instances the writer has noted that other taxpayer's claims for amortization have been disallowed for failure on the taxpayer's part to submit data in accordance with the requirements of the unit, so it would seem that action under these conditions by the committee constituted the most flagran discrimination against other taxpayers."

In the cases referred to in the above criticism the actions of the production committee were based on new and different information, which was furnished by the taxpayers subsequently to the time that the former actions were taken. When the taxpayers learned upon what facilities amortization was allowable and the manner in which the data were required to be submitted they filed amended claims based on facilities originally listed and on other facilities for which no former claims had been made. The amended claims were in accordance with the requirements of the bureau.

The accusation that any taxpayer whose claim was small could have the entire amount allowed by arranging to have the case acted upon by the production committee is wholly without foundation, and this fact could have been readily determined by an open-minded investigation of the facts. In at least one of the cases considered in the report there was a partial disallowance of the amortization claim by the production committee, and in three other cases which were furnished Mr. Thomas but which were not commented upon by him there were also disallowances. The failure to mention these three cases and the fact that in one of the cases reported on there was a partial disallowance are a serious reflection upon the good faith of the accusation.

In conclusion it may be said that in many of the cases covered by Mr. Thomas's report only partial information was referred to, and his criticisms of these cases were necessarily based on assumptions or on partial facts which were misleading. In other cases the information at hand was not considered or was not understood by him, and his conclusions were wholly erroneous. A reply to the criticisms of the individual cases follows.

J. G. Bright,
Deputy Commissioner.

BUFFALO PRESSED STEEL CO., BUFFALO, N. Y.

As stated, Engineer Kahn, of the appraisal section, filed a report on taxpayer's claim August 28, 1920, and recommended an allowance of $3,234.08 and a disallowance of $13,081.09.

The report of the production committee was made October 7, 1924, more than four years later, and was based on entirely new evidence in the case which was not considered by Mr. Kahn or known to be subject to amortization by the taxpayer in 1920. This evidence was furnished by the taxpayer as follows:

1. Affidavit dated February 28, 1924.
2. Conference May 8, 1924, based on above data.
3. Brief dated May 15, 1924, in explanation of affidavit.
4. Supplemental brief in explanation of brief of May 15, 1924.

Based on this data and after a thorough office investigation, the taxpayer's claim was allowed in full. But this allowance was made for articles upon which amortization had not been formerly claimed and which had been included in the new claim of February 28, 1924. Furthermore, there are two memoranda in the case, one dated June 24, 1921, signed by Mr. B. L. Wheeler, acting chief of engineers, and one dated June 27, 1921, signed by Mr. J. R. Little, acting chief of section (amortization audit), calling attention to the fact that Mr. Kahn's basis for making his report was erroneous.

It will be seen from the foregoing that only a part of the facts of the case were considered by Mr. Thomas in his criticism, and the inclusion of new facilities in the claim was entirely overlooked.

WESTERN GRAIN CO., BIRMINGHAM, ALA.

This case was given original consideration by the production committee and after a careful office determination which was approved by the appraisal engineer and was based on taxpayer's sworn statement filed February 26, 1924, an amortization allowance of $2,141.31 was made.

This allowance was based on taxpayer having manufactured articles contributing to the prosecution of the war and having added facilities owing to war demands at a cost greater than postwar replacement costs.

EARLY & DANIEL, CINCINNATI, OHIO

The allowance of amortization to this taxpayer was made after a very careful office determination and the basis for the allowance was recommendation 7911 of the committee on appeals and review, which ruling stated that the facilities acquired by the taxpayer were subject to amortization inasmuch as taxpayer held war contracts and had contributed an article which aided in the prosecution of the war.

Mr. Thomas's criticism is based on an assumption that the original engineer's report was the proper interpretation of the law and that the production committee arbitrarily overruled the engineer. Such criticism resulted possibly from his lack of knowledge of the departmental procedure under which a taxpayer might appeal from the action of the Income Tax Unit to the committee on appeals and review; or, if Mr. Thomas was informed of such procedure then his criticism is the result of an exceedingly careless examination of the file in the case which contained a copy of the recommendation of the committee on appeals and review explaining the basis of the allowance. The criticism in this case is wholly groundless.

ELKHORN COAL & COKE CO., MAYBERRY, W. VA.

This allowance of $7,225.01 as amortization was made after a careful office determination based on the information on file and on an informal conference held with the taxpayer's representative, Mr. A. W. Gaumer. At this conference claim was made for post-war replacement costs in lieu of value in use, and after a careful investigation it was found that 25 per cent was a reasonable allowance, so taxpayer's claim was allowed in full as reasonable.

A subsequent conference report dated January 15, 1925, at which an appraisal engineer, Mr. Tandrow, was present, approves the findings of the production committee but precludes any additional claim.

MASSILLON FOUNDRY & MACHINERY CO., MASSILLON, OHIO

The amortization claimed was allowed in full based on additional information furnished by taxpayer under date of January 21, 1924, and was only made after a careful office determination. With regard to the engineer's report which was voided, it should be noticed that the report was made July 26, 1921, whereas the production committee report was made October 9, 1924, over three years later.

Additional information in the case shows a considerable falling off in production during postwar years and also reveals the fact that taxpayer found the machinery purchased during the war unsuited to its needs and found it necessary to add over $15,000 in additional equipment to maintain even the decreased production. The record amply shows that the machinery purchased during the war period was used almost entirely for war work and the granting of $9,305.87 for amortization was a reasonable allowance.

Giant Furniture Co., High Point, N. C.

The allowance for amortization allowed by the production committee was based on information furnished by the taxpayer subsequent to the engineer's report by a member of the appraisal section. This allowance was only made after a careful study of the data submitted and was based on a bona fide sale of the articles upon which amortization was claimed submitted in affidavit form as follows:

Cost of war facilities (1918 purchases)		$16,576.86
Amounts allowed by Bureau of Aircraft Production	$6,923.39	
Insurance collected on scales	15.00	
Total		6,938.39
Difference		9,638.47
Actual amount received from sales of all war facilities which cost $16,576.86		1,224.41
Amortization allowed		8,414.06

All the above facilities were purchased for war purposes and were subject to amortization. A bona fide sale is the true indication of allowable amortization and is not based on any estimate. It is therefore readily seen that no legitimate criticism can be made of this allowance and that the partial information quoted by Mr. Thomas has no bearing when all the facts are considered.

Sharon Coal & Coke Co., Sharondale, Ky.

The production committee allowed taxpayer's claim for amortization in full after a careful study of all the data in the case, which data were furnished in the form of a sworn statement under date of August 8, 1924, at the request of the engineering division in conference held July 14, 1924.

In this sworn statement taxpayer showed value in use of the housing facilities erected for housing purposes during the war and showed conclusively a reduced value in use during the postwar period which was the basis for allowing the amortization claimed as being a reasonable amount.

In this case as in many others Mr. Thomas has criticized the actions of the production committee without having the full data in the case before him, which was absolutely necessary if correct conclusions were to be drawn.

Keystone Manufacturing Co., Elkins, W. Va.

Taxpayer produced an article contributing to the prosecution of the war. The manufacturing machinery was actually sold in 1919 after serving its purpose. The difference is the true amortization and was allowed, being exactly the amount claimed by the taxpayer.

This allowance was made only after a careful office determination and was approved by the appraisal engineer assigned to the production committee.

In view of the fact that a sale of the property had been made, a field examination by an engineer appeared to be wholly unnecessary.

MILWAUKEE STAMPING CO., WEST ALLIS, WIS.

The amortization allowed this taxpayer was only granted after a careful office determination of all the data furnished. In this determination an engineer from the appraisal section took part.

Taxpayer was engaged in war work and purchased and constructed facilities which were subject to amortization. The data furnished was set up on Form 1007 M and was in every way in compliance with the requirements of the department. Taxpayer's claim for amortization was reasonable and was therefore allowed in full.

LYONS MANUFACTURING CO. AND POTTER BROS. & COLLINS, FRAMINGHAM, MASS.

The facts as stated in the criticism of the allowances for amortization made by the production committee are not correct according to the data in the case, and therefore the criticisms are entirely unfounded.

The facts as supported by the data on file are as follows:

Lyons Manufacturing Co. originally claimed amortization of $3,948.81 on costs of $5,923.22.

Porter Bros. & Collins originally claimed amortization of $15,425.12 based on costs of $30,765.12.

A majority of the records of both companies were destroyed by fires.

The claim of Lyons Manufacturing Co. was based entirely on leather machinery which a sworn statement shows was never used subsequent to the war period. Old records have been secured in part from taxpayer's books not destroyed and in part from correspondence with the company from which purchases were made to show that the original costs of this company were in excess of $4,000 for machinery alone exclusive of costs of installation. Inasmuch as this taxpayer has had no postwar use whatever from this equipment, the only value remaining to taxpayer is a scrap value, and therefore claim for amortization was allowed in full as reasonable, as the scrap value of this material is exceedingly low.

Porter Bros. & Collins originally claimed amortization based on $30,765.12 of costs. Of these costs they have managed to secure records showing purchases of machinery amounting to almost $23,000. This amount does not include freight, installation, labor, belting, etc. A reasonable estimate of these charges would bring the total to almost the figure claimed as costs by the taxpayer, and therefore the original costs were considered as being authentic, as they were claimed at the time of filing the 1918 return.

Mr. Thomas's report which covers both these companies is quoted as follows:

"According to these lists of facilities the cost of those purchased during 1918 was $25,282.16 and the amount realized by the sale of a part of the facilities was $10,146.42, or a difference of $15,135.74

"The taxpayer further states in its letter--

"'After the armistice this machinery was partly used in peace-time business and partly sold.'"

The facts in the case do not warrant any such statement and the impression left by such a statement of the facts is absolutely erroneous.

Taxpayer did manage to secure enough records to tabulate costs of machinery bought during 1918 by both companies amounting to $26,952.16. Taxpayer also furnished a letter written by Orieg Sewing Machine Co., in which they tabulated all the purchases of secondhand machinery made from the taxpayer for the years 1918 to 1920, inclusive. What Mr. Thomas failed to state, however, was that the purchases of the Orieg Sewing Machine Co. from the taxpayer were not in many cases the articles listed by the taxpayer as having been purchased by him in 1918 and upon which amortization was claimed. Thus Mr. Thomas's conclusions are not based on the facts and are entirely erroneous.

The production committee after a careful determination of the facts in the case allowed the amortization claimed for the following reasons:

1. The sales quoted which involved 1918 war-time purchases were made at a loss of 50 per cent which taxpayer claimed as amortization. These sales were a very good indication of the postwar value of these machines, as they were purchased by a concern which required this class of machine. Furthermore, these sales did not reveal the true losses, as the costs of in-

stallation, freight, belting, etc., were not included in the purchase prices quoted by taxpayer.

2. On the balance of the war-time purchases taxpayer was certainly entitled to postwar replacement costs. This allowance was computed to be over 40 per cent on this class of equipment.

3. The combined allowances on this basis equaled the taxpayer's claims, and enough costs had been furnished to substantiate taxpayer's right to amortization on the costs originally specified on the 1918 return.

COBB PRESERVING CO., ROCHESTER, N. Y.

The amortization allowance of $6,091.27 in this case was made after a careful office determination and was based on entirely new data furnished by the taxpayer both in conference and by a sworn statement which was later supplemented by an additional sworn statement. These data were not in the case when the appraisal engineer wrote his report April 4, 1921, whereas the production committee report was made October 20, 1924.

This allowance was granted on an entirely new amortization claim which replaced the old claim. The basis and data compiled in this amortization claim were not known to the engineer who formerly wrote the report, and therefore any comments made with reference to former engineer's report have no bearing whatever upon the reasonableness of the allowance granted by the production committee.

WABASH CANNING CO., WABASH, IND.

The amortization allowed this taxpayer was granted only after a careful office determination and was based on the original amortization claim and on a supplemental sworn statement submitted in response to a request made in conference held by appraisal engineer Watkins.

In reply to Mr. Thomas' criticisms it might be well to note that Mr. Watkins had no authority to promise a field investigation of any case and later this case was deemed to be an office case. Further, it will be noticed that the auditors' conference report makes the statement as regards a field investigation; it is very doubtful if Mr. Watkins made any such statement as his memorandum covering the same conference makes no mention of the promise to make a field investigation.

The allowance made was based on A. R. R. 7911 and the data in the case, which met all the requirements of the unit and amply supported taxpayer's right to amortization; the claim being reasonable, it was allowed in full.

INDIANA RUBBER INSULATED WIRE CO., JONESBORO, IND.

The amortization allowance granted this taxpayer was made only after a very careful office determination of the data submitted by the taxpayer. This examination revealed the facts that the taxpayer produced articles contributing to the prosecution of the war and these products were sold to the Government. The data were in the proper form required by the unit and a study of the tax returns revealed the fact that postwar sales were vastly less than during the war period. The value in use as claimed by the taxpayer was found to be reasonable so the amortization claimed was allowed in full.

ESSMUELLER MILL FURNISHING CO., ST. LOUIS, MO.

A report covering amortization claimed by this taxpayer in its original 1918 return was made by an engineer from the appraisal section on May 29, 1923. Taxpayer protested engineer's findings, which were based on postwar replacement values, under date of August 31, 1923, claiming added amortization based on value in use, but did not submit sufficient data to warrant any increase in the amortization allowance. On August 30, 1924, the unit requested additional data from the taxpayer, outlining the information desired. These data were furnished under date of September 18, 1924, and contained full employment records together with affidavits in support of taxpayer's claim.

Based on this later information, the production committee made a careful office determination of the case and found that the data fully warranted the revised claim of the taxpayer, so amortization claimed in revised schedule of August 31, 1923, was allowed in full as reasonable.

INTERLAKE ENGINEERING CO., CLEVELAND, OHIO

Taxpayer in filing its original returns claimed amortization in the sum of $11,787.93 and wrote off as expense the following items:

Fencing yard	$1,800.40
Electric lights	4,478.97
Track extensions	2,250.00
Grading yard	800.00
Building mold loft and office	10,500.00
Total	19,829.37

Two engineers from the unit investigated the amortization claim in the field and allowed the amount claimed of $11,787.93 in full as being reasonable. When the revenue agent made his report covering the 1918 return he disallowed the $19,829.37 written off as an expense and capitalized the entire amount. Taxpayer protested this disallowance and then claimed that the amounts expended should have been claimed as amortization.

After a careful office determination based on the revenue agent's report, the data in the case, and the taxpayer's protest, amortization was allowed on these items as follows:

Fencing yard	$1,800.40
Electric lights	4,478.97
Track extensions	2,250.00
Building mold loft and office	5,250.00
Total	13,779.37

Taxpayer was certainly entitled to amortization on these facilities, as they were installed under orders from the Shipping Board, from which the taxpayer held contracts. No salvage value was assigned the first three items, as the cost of salvaging was in excess of the salvage yield, which made these items valueless. These facts were submitted in affidavit form and were substantiated by the revenue agent's report.

TREGONING BOAT CO., SEATTLE, WASH.

This case probably more than any other illustrates the improper conclusions which have been drawn by the investigating engineer from a consideration of only a portion of the record and it indicates clearly the inconsequential character of many of the criticisms. The basis of the criticisms is illustrated by the following quotation from Mr. Thomas's report:

"There appears in the file a copy of Engineer Clack's report, which bears his signature, to which is attached a pencil memorandum as follows:

"'TREGONING BOAT CO.

"'Taxpayer's claim for 1918 allowed in full as "reasonable" before this report was submitted.

"'Taxpayer also claimed amortization in 1919, this being covered in this report.

"'J. M. C.'

"From the above-quoted memorandum it would seem that the committee had entirely ignored the taxpayer's claim for 1919 amortization."

On the basis of this pencil memorandum by the engineer and without examination of the file it is made to appear that the production committee overlooked the taxpayer's claim for the year 1919, when as a matter of fact the taxpayer itself withdrew its claim for amortization for the year 1919.

The facts in the case are as follows:

Taxpayer originally claimed amortization in both the 1918 and 1919 returns of $18,825 for each year, or a total of $37,650 in all. Later a revised claim was made in which taxpayer claimed total amortization of $11,442.85, all of which was claimed as a deduction against 1918 income. These facts are also stated as outlined here in paragraph 4 of a report written by Engineer J. M. Clack.

Based on this revised claim and the data accompanying same, the production committee after careful office determination allowed the taxpayer's amended amortization claim of $11,442.85 in full as reasonable. At this time it was not known to the production committee that an engineer from the appraisal section was making a field investigation of this case. Subsequently Engineer J. M. Clack returned from the field and wrote his report, based on a thorough field investigation of the case, in which he allowed taxpayer's amended claim of $11,442.85 in full as reasonable.

This is not merely a coincidence, but shows conclusively that the determinations made by the production committee were based on facts which were given careful thought and consideration.

SENATE COMMITTEE INGESTIGATING BUREAU OF INTERNAL REVENUE,
INCOME TAX UNIT,
September 5, 1925.

To: Mr. L. C. Manson, general counsel.
From: Mr. R. C. Thomas, investigating engineer.
Subject: Reply to criticism of Mr. J. G. Bright, Deputy Commissioner of Internal Revenue, of report submitted by investigating committee engineer on 17 amortization cases as passed on by the production committee of the Income Tax Unit.

The writer has carefully noted the memorandum of Mr. J. G. Bright, Deputy Commissioner, headed "Criticism of amortization allowances recommended by the production committee of the engineering division," and dated July 8, 1925. Before entering into a discussion of this memorandum it is deemed advisable to make a brief statement covering the events leading up to the investigation by the writer of amortization claims of 17 different taxpayers which were passed upon by the production committee.

The attention of the writer was called to the fact that the production committee had passed upon a considerable number of amortization cases, some of which had been investigated by an appraisal engineer of the unit, which engineer had in some instances submitted a report making certain recommendations for amortization allowances and that these recommendations were entirely ignored by the production committee, which, to all appearances, made arbitrary recommendations of allowances without due regard having been paid to the facts in each case.

In order to follow up this matter and to determine just what the action of the production committee had been, the writer requested the engineering papers on various taxpayers' claims. Particular attention is directed to the wording of the written request for certain of these cases. It was as follows:

"Please deliver to room 2308, Treasury Annex No. 2, engineering data files for the following cases."

Certain files were delivered to the writer on 17 or 18 of the cases requested, and the writer proceeded to investigate the findings of the production committee in each case. It was immediately discovered that certain of the files as delivered to the writer were incomplete, and it is remembered quite distinctly by the writer that in one instance there was absolutely no information or data upon which any intelligent report could be made. Seventeen of the files, however, did have sufficient data upon which to base a report. This report was submitted to you by the writer under date of May 23, 1925.

In this report the writer severely criticized the action of the production committee in its arbitrary manner of making certain recommendations, and after having made a thorough study of this report, together with the criticism of same by Mr. Bright, the writer is even more convinced than before that his prior criticisms were well founded, and he even now believes that a part of the engineering papers were either withheld from him—he will not say purposely—or were so completely lost in the defective filing system in vogue in the unit as to be unavailable at the time the investigation was made.

In his criticism Mr. Bright states:

"To some extent Mr. Thomas's criticisms are based on lack of knowledge of the functions of the production committee and of its method of action, and to a very large extent his criticisms are based on assumptions of fact which are not borne out by the records."

In this connection the writer desires to state that if Mr. Bright is correct in his contention that the criticisms were based on "lack of knowledge of the functions of the production committee and of its method of action" the writer does not hesitate to say that such "lack of knowledge" was entirely due to either the inability or the deliberate refusal of the chairman of the production committee to give the information asked for at a conference between the writer and the chairman of the committee, at which conference the writer requested information covering both the functions of the production committee and its method of action.

This interview was sought by the writer with the distinct purpose of acquainting himself with the entire history of the organization and functioning of, and methods used by, the production committee, and after much questioning by the writer the only information obtained from Mr. Rashleigh was, as stated in the original report to you, that the committee was organized at the suggestion of Mr. Rashleigh to Mr. Greenidge, chief of the engineering section. Further, that the cases to be handled by the committee were to be divided into three classes, as follows:

1. Cases where allowances were made in full amount of claim.
2. Cases where total disallowances were made.
3. Cases which would be turned over to the appraisal engineers for final recommendation.

Mr. Rashleigh stated at this interview that his suggestion of the organization of the committee was approved by both Mr. Keenan, head of the appraisal section, and Mr. Greenidge, above referred to. The writer does not hesitate to say that Mr. Rashleigh's whole attitude during this interview was one of secrecy and it was most apparent that he was loath to give out any information whatever. The reason for this attitude is perfectly evident to the writer at this writing.

During the investigation of the production committee's work the whole method of procedure followed by it, its startling arbitrariness, its utter disregard of established facts, and its high-handed way of overruling the appraisal engineers who had in some cases made a field examination of the claims involved, and who were naturally much more conversant with the actual facts, was so evident that a written request, dated May 14, 1925 and addressed to Mr. Bright, was made for a list of all cases handled by the production committee, together with the following information:

1. Whether taxpayer's claim was allowed or disallowed.
2. If allowed, amount of allowance.
3. Date of final action by the committee.
4. Whether case was previously reported on by one of the unit's engineers.
5. Recommendation of engineers.

After waiting for a reply to this request for a considerable time, the writer asked Mr. Greenidge, chief of the engineering section, when he might expect the information desired and was told most emphatically that he would not get the information asked for for the reason that there was no record of it in the files of the unit. In other words, according to Mr. Greenidge, no record of the cases handled by the production committee was kept by either the committee or the engineering section.

Subsequently, or on June 27, 1925 (six weeks later), Mr. Nash, acting commissioner, addressed a communication to yourself as general counsel of the investigating committee, in which the following appears:

"With reference to the communication of May 14 addressed to Mr. Bright in regard to the work of the production committee of the engineering division, Mr. Bright states that the representatives of your committee have been informed that it is absolutely impossible to provide the information therein requested. No list of the names of the cases examined and acted upon by the production committee has been kept, nor has a record been made of the five items requested in your letter of May 14. To prepare such a list would necessitate a search of the entire files of the Income Tax Unit, which would be a stupendous undertaking."

Thus it will be seen that the production committee passed on cases of an unknown number and allowed amortization in an unknown amount without any record having been kept of whether the taxpayer's claim was allowed or disallowed, the amount of the allowance, if any, the date upon which such allowance was made, whether or not engineering features of the cases had even been considered by the amortization engineers of the unit, and in cases in which engineers did make an examination and filed a report, what the recommendation of such reports were. The writer fails to see how the chief of the engineering division could allow such a condition to exist in the division.

As to the latter part of the passage above quoted from Mr. Bright's memorandum, the writer desires to state that in the entire report on these 17 cases the writer conscientiously refrained from making a single assumption, and every statement made in his report was based on the papers in the respective cases as submitted to him by the unit, and he does not hesitate to say that if there was evidence in contradiction to the statements made in his report, then it was entirely the fault of the unit in not having furnished him with the complete engineering files as requested.

Mr. Bright also states that "the cases referred to by Mr. Thomas were all classified as office determinations; that is, cases where the amount of tax and the principles involved *did not warrant a field investigation.*" (Italics by writer.) In connection with the above quotation the writer begs to call attention to the fact that according to the engineer's reports field examinations were made in the following cases:

1. Massillon Foundry & Machine Co.
2. Cobb Preserving Co.
3. Essmueller Mill Furnishing Co.
4. Inter-Lake Engineering Co.
5. Tregoning Boat Co.

Mr. Bright states further that an appraisal engineer approved any of the actions taken by other members of the production committee before the case was finally passed upon. The writer desires to state in this connection that he failed to find in a single instance any record of any of the 17 cases as having been approved by an appraisal engineer as such, but if an appraisal engineer did approve any of the actions of the other members of the committee, such approval must have been of an oral nature. It should be noted that Mr. Bright states that the engineer approved "any of the actions taken by *other* members of the production committee." (Italics by writer.) This would imply that the engineer who approved the actions of the committee was a member of the committee, whereas, as a matter of fact, the committee was composed of Mr. Rashleigh and Mr. Shepard, neither of whom were amortization engineers.

Again quoting from Mr. Bright's memorandum—

"Whenever a prior report of an engineer was disregarded, it was generally because of the additional information furnished by the taxpayer which warranted the change in the amortization allowance. No lengthy discussion of the reasons for allowing the taxpayer's claim was made because expeditious action was desired but a study of the information in each case reveals that ample information was present to justify the allowance made."

Commenting on the above, the writer desires to state that if such additional information as referred to by Mr. Bright was in the possession of the unit it was not furnished to the writer, and he therefore could have no knowledge of the same.

Mr. Bright further states that—

"In many of the cases criticised by Mr. Thomas, the allowances made by the production committee were based on postwar replacement costs, whereas the original amortization claims made by the taxpayers were based on value in use and the engineer's report made accordingly. Subsequently to the making of the engineer's report, taxpayers changed the basis of their claims from that of value in use to that of postwar replacement costs. In other cases where there was no change in the basis of the taxpayers' claims the action of the production committee was taken several years subsequently to the appraisal engineer's report and in the interim there was ample opportunity for considerable change in the value in use of the facilities."

In his investigation of the several claims involved, the writer can not recall at this time a single instance where a different basis of claim was used by the taxpayer subsequent to the making of the engineer's report, and if Mr. Bright is able to cite any such case the writer would be only too glad to revise his former report to coincide with the new evidence in hand.

As to the last part of the above quotation, there was absolutely no evidence in the files as submitted to the writer which would even intimate that any change in the value in use of involved facilities of the taxpayers had ever been made by any engineer of the unit, subsequent to the engineer's report as furnished to the writer, and it is perfectly evident from an engineering standpoint that no reduced value in use of facilities could be properly considered by the production committee unless a field examination had been made, and inasmuch as Mr. Bright states in the earlier part of his memorandum that cases of this character "did not warrant a field investigation," it seems safe to say that they surely did not warrant a second field investigation in order that a redetermination of the taxpayer's claim might be made. Certainly there was nothing in the record as presented to the writer to even hint at such a redetermination or field investigation ever having been made.

In his former report to you the writer stated—

"That this committee, without explanation and without apparent justification, overruled both the recommendations of the appraisal engineers and the action of conference committees, which committees meet for the specific purpose of determining amortization questions and before which both the taxpayer's and unit's representatives were present to present their respective sides of the cases and to thoroughly discuss the merits of same.

"That this committee allowed amortization in cases where the data submitted by the taxpayer were not in accordance with the requirements of the unit. In many instances the writer has noted that other taxpayers' claims for amortization have been disallowed for failure on the taxpayers' part to submit data in accordance with the requirements of the unit, so it would seem that action under these conditions by the committee constituted the most flagrant discrimination against other taxpayers."

In criticizing the two paragraphs just quoted, Mr. Bright states:

"In the cases referred to in the above criticism, the actions of the production committee were based on new and different information which was furnished by the taxpayers subsequently to the time that the former actions were taken. When the taxpayers learned upon what facilities amortization was allowable and the manner in which the data were required to be submitted they filed amended claims based on facilities originally listed and on other facilities for which no former claims had been made. The amended claims were in accordance with the requirements of the bureau."

The writer desires to state that in each and every case investigated and reported on by him, the last report of the engineer, which was supposed to be based upon the most recent data submitted by the taxpayer, was used as a basis of his criticism, and as stated before, if any additional data happened to be in the hands of the unit, it was not included in the files as turned over to him. Mr. Bright further states:

"The accusation that any taxpayer whose claim was small could have the entire amount allowed by arranging to have the case ected upon by the production committee is wholly without foundation, and this fact could have been readily determined by an open-minded investigation of the facts. In at least one of the cases considered in the report, there was a partial disallowance of the amortization claim by the production committee, and in three other cases which were furnished Mr. Thomas but which were not commented upon by him, there were also disallowances. The failure to mention these three cases, and the fact that in one of the cases reported on there was a partial disallowance, are a serious reflection upon the good faith of the accusation."

The above quotation reminds the writer of the "drowning man grasping at a straw." The writer must admit, in all fairness, that in one claim, namely, the claim of the Inter-Lake Engineering Co., a partial disallowance was recommended by the committee. Even taking this into consideration, it will be seen from the record that 16 out of 17 of the taxpayers received the full amount claimed for amortization while one taxpayer claimed $31,617.30, $25,567.30 of which was allowed and $8,050 was disallowed. In other words, of a total amount claimed, $202,843.45, $196,793.45 was allowed and $6,050 disallowed. So it is seen that the writer was not far wrong when he made the statement above referred to by Mr. Bright.

Mr. Bright's statement, as quoted above, that the writer's accusation that any taxpayer whose claim was small could have the entire amount allowed by arranging to have the case acted upon by the production committee, is wholly without foundation, and that "this fact could have been readily determined by an open-minded investigation of the facts," is rather a weak way of defending this action on the part of the committee. The investigation as made by the writer was entirely open-minded and the report written as a result of this investigation was based entirely upon facts as contained in the files furnished the writer by the unit. The writer does not recall the three other cases referred to by Mr. Bright, which were not reported upon. As stated at the beginning of this report, there was one folder which was supposed to contain the engineering files of the case which had absolutely no data in it on which a report could be written. The other two cases referred to by Mr. Bright can not be recalled at this time, but if the writer's recollection is correct he feels sure that every case in which the files were submitted to him, was reported on, and he would be very glad to make a supplemental report on the three cases in question if Mr. Bright sees fit to furnish him with the engineering papers involved.

Following is a discussion of the individual cases touched upon by Mr. Bright in his memorandum:

BUFFALO PRESSED STEEL CO., BUFFALO, N. Y.

Mr. Bright states that the production committee made its report on October 7, 1924, or more than four years after the report of Engineer Kahn, in which report the engineer recommended an allowance of $3,234.08 and a disallowance of $13,081.09. Mr. Bright further states that the report of the production committee was based on entirely new evidence in the case which was not considered by Mr. Kahn. In his memorandum he refers to four papers which go to make up this new evidence. The writer most emphatically states that these four papers referred to were not contained in the files as delivered to him at the time of his investigation. Further, that the recommendation of the production committee was so glaringly in error and in such direct opposition to the rules and regulations of the unit that the writer conferred with Mr. Kahn and reviewed his report in a most thorough manner with him, going over all of the data in the case which he had in hand, with the result that Mr. Kahn advised him that he was still of the opinion that his recommendation was sound and that the only reason he did not place himself on record in the matter was that the amount involved was comparatively small and the case was closed.

In summation of these facts the writer still maintains that his criticism of this particular case is well founded.

WESTERN GRAIN CO., BIRMINGHAM, ALA.

The writer's original criticism of this case was that the production committee acted without having sufficient information at hand to permit of an intelligent recommendation. Mr. Bright's reply to this criticism is that the case was given—

"original consideration by the production committee, and after a careful office determination, which was approved by the appraisal engineer and was based on taxpayer's sworn statement, filed February 26, 1924, an amortization allowance of $2,141.31 was made."

As stated in the writer's original criticism of this case, there was nothing in the engineering files as submitted to the writer which even indicated that the case was ever considered by an appraisal engineer. If an office determination was made by an appraisal engineer, as stated by Mr. Bright, there was nothing in the record as submitted to the writer to show it.

It is respectfully requested that Mr. Bright furnish us with the name of the engineer who approved the action of the production committee in this case.

Early & Daniel, Cincinnati, Ohio

Mr. Bright states that the writers' criticism was based either on an assumption that the original engineer's report was the proper interpretation of the law or from lack of knowledge of the departmental procedure under which a taxpayer might appeal to the committee on appeals and review. Further, that the file in the case contained a copy of the recommendation of the committee on appeals and review explaining the basis of the allowance.

Mr. Bright does not give the date of the action of the committee on appeals and review, neither does he state whether such action was taken subsequent to the action of the production committee or prior thereto. However, from the record it would appear that Mr. Bright entirely overlooked a communication addressed by him to the committee on appeals and review, in which the following appears:

"The facilities were not for the production of articles but were for the performance of service only. It is contended that the phrase 'production of articles' relates to some form of manufacturing (see L. O. 1074, 45-21-1909, C. B. No. 5, p. 159), and that the purpose of the taxpayer's facilities is clearly shown to be related to transportation. (See taxpayer's claim and brief.)"

The writer has no recollection of ever having seen the report of the committee on appeals and review, but assuming that such a report was sumbitted and that an allowance in the full amount of the taxpayer's claim was made by the committee on appeals and review, the writer still maintains that his criticism is well founded for the reason that it is not believed that the production committee should have had the case before them if action had been taken by the committee on appeals and review.

The question involved was as to whether or not this taxpayer produced an article contributing to the prosecution of the war. From Mr. Bright's memorandum it would appear that the committee on appeals and review had ruled that the taxpayer did produce an article or articles necessary for the prosecution of the war, but the writer maintains that it was not within the province of the production committee to determine what amount of amortization was allowable, but that this question should have been referred to one of the amortization engineers for determination, which engineer should have based a redetermination of the taxpayer's claim on the action of the committee on appeals and review.

Mr. Bright states earlier in his memorandum that whenever doubt existed the appraisal engineer assigned to the production committee was consulted, and, further, that this appraisal engineer approved any of the actions taken by other members of the production committee before the case was finally passed upon.

As stated before, the writer has been unable to find a single instance in which an amortization or appraisal engineer passed upon any of the 17 cases in hand. It may be that an appraisal or amortization engineer was consulted in some of the cases, but if so his ruling or rulings were never made a part of the record, and necessarily must have been oral in nature. If so, it appears to the writer that it is a decidedly faulty method of procedure and an extremely unsound way to conduct the Government's business.

The writer wishes to make it plain that he does not say that an appraisal or amortization engineer was never consulted in these cases, nor that his opinion was not followed by the committee, but he does most emphatically say that there was nothing in the record as presented to him to show that such was the case.

Elkhorn Coal & Coke Co., Mayberry, W. Va.

In the writer's original report on this case it was stated that it had not been referred to the unit's engineers in the usual way and that no field investigation or report had been made thereon. The claim was in the sum of $7,225.01 and was based on postwar value in use. As stated in the writer's original criticism of the production committee's action in allowing the full amount claimed as amortization, the taxpayer provided certain production figures which showed conclusively that the average production of coal in postwar years was greater than the average in the war-time years, and that the average combined production of both coal and coke in the postwar years nearly equaled that of the war-time years, and further, that during 1921 and 1922 the production of coal exceeded the production of both coal and coke during the war period, or 1917 and 1918.

For these reasons the writer contended that no amortization should have been allowed, as it was evident from the taxpayer's own figures that the facilities involved must have been 100 per cent in use during the postwar period. However, Mr. Bright states in his memorandum that the allowance of the full amount claimed was based on the information on file and on an informal conference held with the taxpayer's representative, at which conference the claim was made in the same amount ($7,225.01) on the basis of postwar replacement costs. This is another instance of the files of the unit not being complete, as the writer is positive that there was no mention made of the change from the postwar production basis to the postwar replacement cost basis, and the writer's first criticism was based entirely on the data furnished him by the unit.

Massillon Foundry & Machinery Co., Massillon, Ohio

The writer's original criticism of the handling of this case by the production committee was based on the following facts:

That Engineer L. E. Luce made a field investigation of the case and submitted a report thereon, dated July 26, 1921, in which he recommended an allowance for amortization in the sum of $219.64 of a total claimed of $9,305.87. This amortization allowance was based on value in use during the postwar period. And that, as shown in Mr. Luce's report, almost all the facilities were necessary in the taxpayer's business during 1919 and 1920, and were approximately 100 per cent in use. Further, that the production committee overruled the engineer's report, and without any valid reason for so doing allowed the full amount claimed as amortization. Mr. Bright states:

"With regard to the engineer's report which was voided, it should be noticed that the report was made July 26, 1921, whereas the production committee report was made October 9, 1924, over three years later."

The writer fails to see that it makes the least bit of difference whether the production committee's report was submitted three years after the engineer's report or three days thereafter. The fact remains that the engineer who made the field examination, and who was thoroughly familiar with all the details of the case, was overruled by the committee, without even being consulted in the matter. Mr. Bright further states that additional information in the case was produced which revealed the fact that the taxpayer found the machinery purchased during the war unsuited to its needs and found it necessary to add a considerable sum in additional equipment to maintain even the decreased production. He further states that—

"The record amply shows that the machinery purchased during the war period was used almost entirely for war work and the granting of $9,305.87 for amortization was a reasonable allowance."

Massillon Foundry & Machinery Co.

As stated in the writer's original criticism, there was nothing in the files as delivered to him which revealed the fact that the taxpayer found the machinery purchased during the war unsuited to its needs and found it necessary to add additional equipment, nor did the record as submitted to the writer contain any papers which would tend to show "that the machinery purchased during the war period was used almost entirely for war work and the granting of $9,305.87 for amortization was a reasonable allowance."

Again we have a case where it would seem that the record as submitted to the writer was incomplete.

Giant Furniture Co., High Point, N. C.

In the original criticism of the action of the production committee in this case, the writer stated that the taxpayer's claim was in the sum of $8,414.06. This taxpayer received the sum of $6,923.39 from the Bureau of Aircraft Production.

On March 7, 1924, an auditor of the amortization section submitted a memorandum on this case in which he agreed with the findings of Engineer Pagter whose report was submitted on December 19, 1923, and in which he recommended as follows:

"It is, therefore, recommended that the entire case be transferred, with transmittal form 1932, to the engineering division, appraisal section, for determination of the amount of amortization, if any, that is allowable * * *."

In this same criticism the writer stated that this was another case where the recommendations of the engineer who had investigated the case and who had set forth valid reasons for the disallowance of the claim had been set aside by the committee for no apparent reason and without any explanation.

Mr. Bright, in discussing this case in which the production committee allowed the full amount claimed, says:

"This allowance was made after a careful study of the data submitted, and was based on a bona fide sale of the articles on which amortization was claimed submitted in affidavit form as follows."

The writer has no recollection whatever of ever having seen any evidence in the files as presented to him, of such a sale ever having been consummated, but assuming that a bona fide sale was made, it seems that the proper way to handle the case would have been to refer the data to the engineer who made the original report and have a redetermination of the case made by him. As quoted above, the auditor recommended that the entire case be transferred to the engineering division, appraisal section, for determination, but even in the face of this, the production committee saw fit to take the case in its own hands and allow amortization in the full amount claimed without first consulting Engineer Pagter.

SHARON COAL & COKE CO., SHARON, KY.

This taxpayer's claim was for amortization of housing facilities and was in the sum of $5,610.41. As stated in the original report of the writer, a conference was held with the taxpayer's representative on July 16, 1924, at which the taxpayer was requested to submit certain information in accordance with Form 1007–M, together with other supporting data. Further, that on August 19, 1924, the engineering division was requested by Mr. Kensel, assistant head of division, to give the case early attention.

The fact of Mr. Kensel's request appealed to the writer as being rather unusual in a case of such small importance, and he made extra efforts to get all of the data possible which would throw any additional light on the case and would explain why the production committee approved the claim in full on October 14, 1924, without having received the requested information from the taxpayer, as there was nothing in the files of this case as delivered to the writer to show that this information had been submitted by the taxpayer. The writer personally visited the office of Mr. Rashleigh and requested that a search be made for additional data. He was told that all of the data in this case had been turned over to him.

Mr. Bright states in his memorandum, however, that the data referred to and which was requested at the conference of July, 1924, was furnished by the taxpayer in the form of a sworn statement under date of August 8, 1924, and that it was upon this data that the production committee reached its conclusion. Mr. Bright further states:

"In this case, as in many others, Mr. Thomas has criticized the actions of the production committee without having the full data in the case before him, which was absolutely necessary if correct conclusions were to be drawn."

The writer agrees entirely with Mr. Bright that it was necessary to have the full data in the case before him in order that correct conclusions might be drawn; but he states without fear of contradiction that the sworn statement referred to by Mr. Bright was not included in the data furnished to him by the unit, and had this data been furnished as requested, the writer's criticism of the case might have been of an entirely different nature.

KEYSTONE MANUFACTURING CO., ELKINS, W. VA.

This taxpayer filed a claim for amortization in the sum of $5,479.51 for facilities used in the manufacture of wood trennails for Government ships. The case was sent to the head, engineering division, attention of appraisal section, on July 9, 1924, for proper action. On August 20, 1924, Mr. Bright sent a communication to the taxpayer requesting certain additional information bearing on its claim. To this request the taxpayer replied on August 26, 1924, and supplied the information asked for. On August 28, 1924, Mr. Bright acknowledged the receipt of this information and stated:

"Claim has been referred to the engineer assigned to the case for his prompt attention."

In the writer's original report on this case he criticized the production committee for having allowed the claim in full without first getting a report from the engineer assigned to the case, as there was nothing in the files to show that one of the appraisal enginers had ever investigated the claim. Mr. Bright in his memorandum states that the allowance was made "only after a careful office determination and was approved by the appraisal engineer assigned to the production committee."

There was nothing in the record as presented to the writer to show that an appraisal engineer had been assigned to the production committee, nor was there anything in the production committee's report to show that its allowance in full had ever been approved by any appraisal engineer. If an appraisal engineer did approve the committee's action, it must have been oral, which, as stated before, is considered to be rather a lax method of conducting the Government's business in matters of this character.

It is respectfully requested that Mr. Bright furnish us with the name of the engineer who approved the action of the production committee in this case.

MILWAUKEE STAMPING CO., WEST ALLIS, WIS.

This taxpayer claimed amortization in the sum of $16,256.32. In the writer's original report on this claim it is stated that no investigation was made by an appraisal engineer of the unit in the usual way but that the claim was reported upon by a revenue agent who was not an engineer but an auditor. This report was dated April 19, 1920, and carried with it an allowance of $841.40 without any explanation or comment.

The committee allowed the claim in the full amount of $16,256.32, there being nothing in the record to show that any appraisal engineer had ever considered the case. Mr. Bright's only explanation of the action of the committee in this case, and his only answer to the writer's criticism is as follows:

"The amortization allowed this taxpayer was only granted after a careful office determination of all the data furnished. In this determination an engineer from the appraisal section took part.

"Taxpayer was engaged in war work and purchased and constructed facilities which were subject to amortization. The data furnished was set up on Form 1007 M and was in every way in compliance with the requirements of the department. Taxpayer's claim for amortization was reasonable and was therefore allowed in full."

It is respectfully requested that Mr. Bright furnish us with the name of the engineer who approved the action of the production committee in this case.

LYONS MANUFACTURING CO., FRAMINGHAM, MASS.

Mr. Bright states in his memorandum that the facts as stated in the criticism of the writer in this case are entirely unfounded; also that the facts in the case do not warrant the statements as made by the writer, and, further, that the impression left by such statements as made by the writer, is "absolutely erroneous." The writer wishes to say that the only facts stated in his original criticism of this case were facts as taken from the record as presented to him, and he takes issue with Mr. Bright in his statement that the impression left by the writer's statements is "absolutely erroneous."

The chief criticism of the case as contained in the writer's original report was the fact that the production committee acted in the matter without having sufficient data before it. He distinctly states that he does not question the fact that some deduction for amortization was proper, but he maintains that the allowance of the total amount of the claim was excessive.

It so happens that a fire occurred at this contractor's plant which destroyed a large part of their records, and from the files which the writer had before him when his original report was written it is unquestionably true that the list of facilities upon which amortization was claimed, as furnished by the taxpayer, together with the list of facilities sold after the war period, were incomplete. A part of the taxpayer's letter submitting these lists reads:

"This list is not necessarily complete, since the company suffered a severe fire loss in 1920, as explained in the conference, and all the records of the company were lost at that time. However, we believe that the list comprises a large majority of the invoices rendered, but we can not say definitely which invoices are applicable to the Lyons Manufacturing Co., and which to the Porter Bros. & Collins, as all the purchasing at that time was done on the credit of the latter company and invoices were practically and invariably rendered to Porter Bros. & Collins."

The above quotation seems to establish beyond any doubt that the data as presented by the taxpayer was not complete. There appeared in the files a pencil memorandum written on a piece of wrapping paper, and unsigned, as follows:

"Records destroyed Zolzer exam early in 1923; never wrote report waiting for data.

"Data such as is finally came in not believed can allow any original costs and shown. Sold some, but can not identify with cost * * *."

If these pencil memoranda just quoted mean anything they surely substantiate the writer's contention that the data as furnished by the taxpayer was incomplete, and the writer challenges Mr. Bright's statement to the effect that his conclusions "are not based on the facts and are entirely erroneous."

In conclusion of this case, the writer desires to call attention to the last paragraph of his original report, which reads as follows:

"The writer would add that in the investigation of the several amortization cases which have come to his attention there have been many cases in which amortization has been disallowed in full for the reason that the taxpayer was unable to furnish sufficient data to support its claim, whereas in these two claims allowances for the full amount claimed have been made."

COBB PRESERVING CO. (SUBSIDIARY OF NEW YORK CANNERS, (INC.)), ROCHESTER, N. Y.

This taxpayer submitted a claim for amortization in the sum of $6,091.27. Engineer William R. Griffith submitted a report on April 4, 1921, covering this claim and recommended disallowance in full, for the reason that—

"The taxpayer held no war contracts and that the amortization period should end November 11, 1918. Further, for the reason that the taxpayer advised him that all facilities would be used in the taxpayer's normal postwar business and that practically all were erected or installed in 1919, or after the amortization period."

The production committee on October 20, 1924, allowed the full amount claimed as amortization. The writer criticized the action of the production committee in not having referred the case back to the engineer who made the field examination and report, and who was thoroughly familiar with the case, after it had received from the taxpayer certain affidavits setting forth the expenditures made prior to November 11, 1918, which, as a matter of fact, was stated by the taxpayer as being "none," and which stated that the taxpayer had entered into a verbal contract on a cost-plus basis on buildings upon which amortization was claimed. According to Mr. Bright's statement, however, the data upon which the production committee's report was based was submitted by the taxpayer subsequent to Mr. Griffith's report, and that the allowance made by the production committee was on an entirely new amortization claim which replaced the old claim. Further, that the basis of the revised claim and data submitted with same were not known to the engineer who formerly wrote this report and that any comments made with reference to the former engineer's report have no bearing whatever upon the reasonableness of the allowance granted by the production committee.

The writer has only to say that not one line appeared in the record, as delivered to him by the unit, which would show that a new claim had been compiled and that new evidence had been furnished upon which the production committee based its report and recommendation. It appears to the writer, however, that this new claim and new evidence should have been referred to one of the appraisal engineers, and, in the writer's mind, to Mr. Griffith, who made the field investigation and wrote the original report before being acted upon by the production committee. To say the least, the method of procedure in this case was not in keeping with the established rules and regulations of the unit.

WABASH CANNING CO., WABASH, IND.

This taxpayer submitted a claim for amortization in the sum of $19,890.64. As stated in the writer's original report, no engineer's report was submitted in this case, but on September 2, 1924, a conference was held with the taxpayer's representatives. The unit's engineer was present at this conference and examined taxpayer's claim. The question arose as to whether or not the taxpayer should be allowed amortization under the statute covering the production of articles contributing to the prosecution of the war. At this conference the taxpayer was requested to supply additional data. Mr. Watkins, the unit's engineer at the conference, requested that the conferees withhold final action in the case until a field report could be submitted by him. This request was granted by the conferees who approved the following:

"The case will be held in the section pending receipt of the amortization engineer's report."

There was nothing in the record as presented to the writer to show that the additional data requested was ever submitted by the taxpayer, but on October 14, 1924, the production committee approved the taxpayer's claim in full. Mr. Bright attempts to cover up this action of the production committee with the following statement:

"In reply to Mr. Thomas's criticisms it might be well to note that Mr. Watkins had no authority to promise a field investigation of any case, and later this case was deemed to be an office case. Further, it will be noticed that the auditor's conference report makes the statement as regards a field investigation; it is very doubtful if Mr. Watkins made any such statement, as his memorandum covering the same conference makes no mention of the promise to conduct a field investigation."

From the above quotation it seems that Mr. Bright was endeavoring to becloud the issue and make it appear that Mr. Watkins overreached his authority by promising the taxpayer to make a field investigation of his claim. From the statement of Mr. Bright that "it is very doubtful if Mr. Watkins made any such statement," it would appear that Mr. Bright or his subordinate who prepared the report for his signature did not take the trouble to look through the record in the case to determine just what action Mr. Watkins really did take in the matter.

The writer states most emphatically that according to the record Mr. Watkins requested the conferees to withhold final action in the case until a field report could be submitted by him. Otherwise why should the conferees have resolved that "the case will be held in the section pending the receipt of the amortization engineer's report."

Again, the writer did not even intimate, much less state, in his original report that Mr. Watkins promised a field investigation, and yet Mr. Bright attempts to make it appear that such was the case.

Mr. Bright further states that "later this case was deemed to be an office case." The writer states most emphatically that there was nothing in the record as presented to him to show that any such decision had been reached or that the question had even been considered by anyone in the unit. According to the record as submitted to the writer, there is absolutely no evidence to show or even suggest that the production committee had before it at the time of approving the taxpayer's claim in full any of the additional data requested by Mr. Watkins of the taxpayer or the amortization engineer's report referred to in the resolution of the conferees. Further, Mr. Bright states in his memorandum that—

"It will be noticed that the auditor's conference report makes the statement as regards a field investigation."

It seems that Mr. Bright takes particular pains not to mention what the statement is, so that this part of Mr. Bright's memorandum is absolutely meaningless. However, it surely is not within the province of an auditor to dictate to the engineering sections as to whether or not a field investigation of a case is warranted.

To sum up the reply of Mr. Bright, it is believed that either Mr. Bright was ill advised in the matter or deliberately attempted to bemuddle the question by insinuations which can in no wise be substantiated by facts.

Indiana Rubber & Insulated Wire Co., Jonesboro, Ind.

This taxpayer was engaged in the manufacture of automobile tires, bicycle tires, and insulated wire and cables, and, according to the record as presented to the writer, it held no Government contracts. A claim for amortization was submitted by the taxpayer in the sum of $17,261.10. This claim was based on "value in use." The taxpayer also claimed depreciation over and above that usually allowed on facilities of a similar character. This depreciation claim was based on the fact that the taxpayer's plant was obliged to work "double time" during 1918 and 1919. The normal depreciation claimed by the taxpayer varied from 3½ per cent on buildings to 20 per cent on reels and vulcanizing pans, while the additional, or what might be termed the overtime, depreciation claimed varied from 6 per cent on "machinery" to 10 per cent on reels and vulcanizing pans.

In his criticism of the production committee's action in this case the writer stated that he was of the opinion that the production committee had no data upon which to base its recommendation other than the taxpayer's brief. Further, that it was his opinion that the case was of sufficient importance and involved questions of sufficiently debatable character to warrant a field investigation or at least a detailed report by one of the amortization engineers. Further, that as the case now stands (in so far as the record as presented to the writer shows) there was no explanation given of the total allowance of the amount claimed by the production committee except that it was "reasonable." Mr. Bright in his memorandum entirely sidesteps the issue in that he states that the allowance is made only after a very careful office determination of the data submitted by the taxpayer. Also that the data were in proper form required by the unit and that the "value in use" as claimed by the taxpayer was found to be reasonable.

As stated in the writer's original report on this case, there was not a word in the record as submitted to him to show that even a careful office determination of the data submitted by the taxpayer had ever been made by any of the appraisal engineers, and as far as this record is concerned the only consideration of the claim that was made was the final action of the production committee. While Mr. Bright states that the "value in use" was found to be reasonable, he entirely disregards one of the main issues in the whole case, namely, the so-called "double-time" depreciation claimed by the taxpayer.

Essmueller Mill Furnishing Co., St. Louis, Mo.

In the original report on this case the writer criticised the production committee's action in allowing amortization in the full amount claimed without first having had the taxpayer's final claim investigated in the regular way by one of the unit's appraisal engineers.

It is true that an appraisal engineer did make a field investigation, together with report on the original claim of the taxpayer. In this report Mr. Henriques, the appraisal engineer, recommended an allowance of $1,355.89. This allowance was based on postwar replacement costs. The report states that—

"It was apparent that the machine in question was in full use further, that the taxpayer made no claim for amortization based on a reduced value in use and it was for that reason that he used the replacement cost basis in his computations."

It should be noted that this recommendation of Mr. Henriques was on the taxpayer's original claim in the sum of $2,000. Further, that the taxpayer submitted a final claim in the sum of $3,152.50. This claim was accompanied by certain supporting data. Mr. Bright states in his memorandum that, based on this later information, the production committee made a careful office determination of the case and found that the data fully warranted the revised claim of the taxpayer. This shows very clearly that the production committee took it upon itself to pass judgment on the engineering features of this taxpayer's claim without having first submitted it either to Mr. Henriques or any of the other appraisal engineers. At least there is nothing in the record as presented to the writer to show that this was done. So the writer is still of the opinion that his former criticism was fully justified and that an appraisal engineer should have submitted a report in the regular way on this case before any action was taken by the production committee.

INTERSTATE ENGINEERING CO., CLEVELAND, OHIO

In its original return this taxpayer claimed amortization in the sum of $11,787.93. A field examination of this claim was made by two of the unit's engineers, Messrs. Coombs and Moore. The report of these engineers carried with it a recommendation for allowable amortization in the sum of the full amount claimed ($11,787.93). This taxpayer also wrote off as expense items amounting to $19,829.37, but when the revenue agent made his examination and report covering the 1918 return he disallowed this write-off in full as an expense and capitalized the entire amount. The taxpayer protested this disallowance and claimed the amounts expended should have been claimed as amortization.

It should be noted that this write-off of $19,829.37 is in addition to the original amortization claim of $11,787.93. The two amounts added together, which go to make up the taxpayer's final claim, is $31,617.30.

On October 7, 1924, the production committee acted on this case and adopted a resolution which contained a recommendation of allowance in the sum of $13,779.37, and also states in this resolution, "this recommendation voids report dated August 8, 1922." (This report is the report of Messrs. Coombs and Moore.) From this it would appear that the production committee had entirely ignored the taxpayer's original claim for $11,787.93 which had been allowed by the unit's engineers. Subsequently the production committee evidently realized that an error had been made in its recommendation of October 7, 1924, and made a supplemental recommendation in which the recommendation of the engineers referred to was included in allowable amortization, thereby making the total amount allowed by the production committee $25,567.30. There is nothing in Mr. Bright's memorandum which attempts to contradict the above statements of the writer, but, on the contrary, he states that amortization was allowed on the basis of the revenue agent's report in the sum of $13,779.37. He, however, leaves out entirely the former allowance made by the unit's engineers in the sum of $11,787.93, which goes to make up the total allowance finally allowed by the production committee of $25,567.30, and it would appear from Mr. Bright's memorandum that the $13,779.37 was the only amount allowed, whereas the recommendation of the production committee reads as follows:

"Recommended that amortization be allowed as follows: * * * Total, $13,779.37. This allowance is in addition to amortization allowed in engineer's report dated August 8, 1922 * * *."

The writer did not criticise the production committee in allowing the amount recommended by the engineers, together with an additional amount based on their recommendations, but he did criticise the fact that no salvage value of certain materials upon which amortization was allowed was taken into consideration. Also that no field investigation of the taxpayer's final claim was made, and the record as submitted to him did not contain any evidence which would show that it had ever been considered by one of the appraisal engineers in the regular way.

As to the salvage values above mentioned, Mr. Bright states that no salvage value was assigned for the reason that the salvage was in excess of the salvage yield, which made the items valueless. These items referred to include track extensions in the amount of $2,250. It is the belief of the writer that had an appraisal engineer investigated this claim in the regular way the salvage value would have been taken into consideration and would necessarily have reduced the amount of allowable amortization. This is believed for the reason that the writer can not recall a single instance where material of this character, namely, trackage, cost more to salvage than the salvage yield. In this connection the writer states that during his four years' connection with the claims section of the United States Shipping Board he had occasion to investigate many claims of contractors who installed trackage, and he can not recall a single instance in which trackage did not carry with it a certain salvage value; nor can he recall an instance where the contractor even co nded that it had no salvage value.

TREGONING BOAT CO., SEATTLE, WASH.

This taxpayer submitted a claim for amortization as follows:

1918	$18,825
1919	18,825
Total	37,650

Appraisal Engineer Clack made a field investigation of this claim, and in his official report to the unit recommended an allowance in the sum of $11,442.85. In his memorandum on this case Mr. Bright states:

"This case, probably more than any other, illustrates the improper conclusions which have been drawn by the investigating engineer from a consideration of only a portion of the record, and it indicates clearly the inconsequential character of many of his criticisms * * *."

The writer takes exception to this statement of Mr. Bright and respectfully refers him to the original report submitted May 23, 1925, in which the writer states that the production committee allowed amortization in the sum of $11,442.85. There also appears in this report a statement to the effect that attached to the unit's engineer's report was a memorandum as follows:

"Taxpayer's claim for 1918 allowed in full is reasonable before this report was submitted."

Also:

"Taxpayer also claimed amortization in 1919, this being covered in this report. J. M. C."

The initials "J. M. C." are assumed to be those of Mr. J. M. Clack, appraisal engineer of the unit, who wrote the report referred to.

It is evident from the above quotation that the taxpayer's claim for 1918 was allowed before Mr. Clack's original report was submitted. Further, that the report submitted by Mr. Clack covered only the claim for amortization in 1919. It should be borne in mind that the recommended allowance of Mr. Clack was the same as that recommended by the production committee, namely, $11,442.85, which goes to show that it covered only the part of the taxpayer's claim which was included in Mr. Clack's report and did not cover the part referred to in Mr. Clack's memorandum as having been allowed prior to the submission of his report. Mr. Bright states that the taxpayer withdrew his claim for amortization for the year 1919. Also that the writer based his criticism on this memorandum of Mr. Clack's without examining the file. The writer concurs in Mr. Bright's statement that his criticism was to a great extent based on Mr. Clack's memorandum; but this memorandum, it must be remembered, was a part of the record and should carry as much weight in so far as actual facts are concerned as any other part of the record. But Mr. Bright is entirely in error when he states that the writer did not examine the file. Such a statement is absolutely untrue, and if there is anything in the file that the writer did not examine it was not in the file at the time of the writer's examination of the case.

Mr. Bright further states that at the time the production committee made its recommendation—

"It was not known to the production committee that an engineer from the appraisal section was making a field investigation in the case."

This is taken by the writer as an absolute and direct admission by the deputy commissioner that there was a woeful lack of cooperation between the production committee and the appraisal section of the engineering division. In any event it shows that the two were working independently and that the production committee did not wait until Mr. Clack's report had been compiled before making its recommendation.

Mr. Bright states that—

"Subsequent to the production committee's recommendation, Mr. Clack returned from the field and wrote his report, based on a thorough field investigation of the case,"

and further states that the allowance as recommended by Mr. Clack was precisely the same as the allowance recommended by the production committee, stating:

"This is not merely a coincidence, but shows conclusively that the determinations made by the production committee were based on facts which are given careful thought and consideration."

This last quotation seems to be beyond all power of reasoning. It is not believed that there is one chance in a million of this investigating engineer making a field examination if a claim in which he was able to come in personal contact with every facility involved in the taxpayer's claim upon which amortization was to be allowed, arriving at exactly the same amount to the very cent of allowable amortization as was arrived at by the production committee, who never left their offices in order to make a determination of allowable amortization and who had no way whatever of determining the condition of the facilities involved or the use to which they were being put during the postwar period.

Before concluding, the writer desires to call attention to a phase of this entire matter which has not yet been discussed to any length.

In the early part of this communication the writer stated that he looked into the matter of the organization of the production committee and endeavored to determine in as much detail as was possible, its powers, its functions, its mode of procedure, and the authority under which it was organized. He further stated that he was advised by Mr. Rashleigh, chairman of the committee, that its organization was due to a recommendation by him to Mr. Greenidge, chief of the engineering division, and approved by Mr. Keenan, chief of the appraisal section. From information which has come to light subsequent to the time when the writer made his investigation of this matter, it would appear that the production committee was functioning from October, 1924, to January, 1925, and further, that its very existence was unknown to C. R. Nash, assistant to the Commissioner of Internal Revenue.

The following appears in the record of the hearings before the Senate investigating committee as a part of the testimony given by Mr. Nash on May 26, 1925:

"The CHAIRMAN. Is there any record in the bureau to show how many cases this production committee closed, Mr. Nash?

"Mr. NASH. I did not know there was such a committee until this morning.

"Senator WATSON. I was wondering what the production committee is.

"Mr. NASH. That is, I knew there was a production committee, but I did not know it was functioning in this way.

"Senator WATSON. What is the production committee?

"Mr. NASH. There is a production committee in each audit division who are supposed to be the representatives of the deputy commissioner, and their function is to keep in touch with the cases that are going through, and see that they keep moving, and then report to the deputy commissioner each day the number of cases that go through a division, the number received, the number closed, etc.

"The CHAIRMAN. It is not intended, then, that they should actually pass upon cases?

"Mr. NASH. No, sir; I never understood that to be part of their function at all.

"Mr. MANSON. I had always supposed that their function was to expedite business.

"Mr. NASH. Yes, sir; to push the cases along, so to speak, and to see that the business keeps moving.

"Mr. MANSON. Yes.

"Senator WATSON. They have nothing to do with production of an industry?

Mr. NASH. They are not technical men.

"Senator WATSON. They are to get production in the department, as I understand it; that is, to produce results.

"Mr. NASH. Yes, sir.

"Senator WATSON. I was wondering where they got any authority to pass on cases.

"Mr. THOMAS. I might say, Senator, that I had a talk with Mr. Rashleigh, who is the head of the production committee, which functions as Mr. Nash has just explained. It seems that at that time, as I stated in my report, there were quite a number of small cases, under $25,000, hanging fire in the engineering unit. Mr. Rashleigh, in his capacity to trying to push cases along through the department, recommended to Mr. Greenidge that this production committee be allowed to pass on small claims for amortization. That was approved by Mr. Keenan and by Mr. Greenidge. Then they started to function.

"Mr. MOSS. Is that in the form of any written memorial of any kind?

"Mr. THOMAS. I have never seen anything to indicate that it was.

"Mr. MANSON. Did you ask for it?

"Mr. THOMAS. I asked Mr. Rashleigh how the committee started to function in this procedure and he told me of the approval by Mr. Greenidge and Mr. Keenan on his recommendation.

"The CHAIRMAN. How long did that committee function?

"Mr. THOMAS. So far as I can find, from the first part of October and through November. Mr. Rashleigh was rather vague.

"Mr. NASH. May I ask if there is anything in the record to show whether Mr. Bright had knowledge of this work, or whether he approved it?

"Mr. THOMAS. No, sir; nothing whatever.

"Mr. MOSS. I think, Mr. Chairman, Mr. Nash will want to inquire about this work of the so-called production committee.

"Mr. THOMAS. I do not know whether this committee confined its work to amortization cases or not. I do not know whether they attempted to do anything in the oil and gas section, the metals section, or the nonmetals section. Mr. Parker or Mr. Manson, I think, wrote to Mr. Bright, under date of May 14, asking him for a complete list of all cases handled by that committee, giving the amount allowed, the amount claimed, the date of allowance, and I think whether or not it was acted on by an engineer; and if so, what the engineer's recommendation was. We have received no answer to that.

"The CHAIRMAN. Did you see the letter, Mr. Nash, that Mr. Thomas refers to?

"Mr. NASH. No, sir.

"Mr. MANSON. That letter was signed by Mr. Parker, with my approval.

"The CHAIRMAN. And delivered to Mr. Bright?

"Mr. MANSON. Yes, sir.

"Mr. THOMAS. Mr. Greenidge had it, because he came to me either yesterday or Saturday and asked me if he could have another copy of it, and I supplied him with another copy of it.

"Senator WATSON. How many cases did that production committee actually deal with, Mr. Thomas?

"Mr. MANSON. That is just the information that we have asked for.

"Mr. THOMAS. I have only had 17 of them before me.

"Mr. MANSON. Mr. Thomas's work, outside of some general duties, has been confined to amortization.

"(At 10 o'clock p. m. the committee adjourned.)"

From the above it is plainly evident that a committee was in existence in the engineering division which was allowed to pass on claims amounting to at least $202,843.45, and possibly many times that amount (it has been stated that no record was kept of the cases acted upon by the production committee), without the knowledge of the assistant to the commissioner, and as far as the writer can learn without the knowledge of anyone higher in authority than Mr. Greenidge, chief of the engineering division. Further, it is a fact that this committee was allowed to make recommendations by which taxpayers were relieved of paying into the Treasury of the United States thousands of dollars. These recommendations covered questions of a purely technical character, and it was admitted by Mr. Nash that the two gentlemen who composed this committee were not technical men. Again, it is a fact that these recommendations were made by the production committee and that their records were in such shape that it could not be determined how many cases were handled by the committee and how much money was lost to the Government by reason of taxpayers being allowed to deduct amortization to the extent of thousands of dollars in their 1918 and 1919 tax returns. This, in the writer's opinion, is a deplorable state of affairs, and warrants a thorough investigation in order that it may be determined to what extent this unauthorized committee has relieved taxpayers from the payment of taxes rightly due the Government.

R. C. THOMAS,
Investigating Engineer.

Approved:
L. H. PARKER,
Chief Engineer.

TREASURY DEPARTMENT,
Washington, July 11, 1925.

Hon. JAMES COUZENS,
United States Senate, Washington, D. C.

DEAR SENATOR COUZENS: On May 14 there was taken up by the committee to investigate the Bureau of Internal Revenue the cases of the Union Sulphur Co., the Freeport Texas Co., and the Texas Gulf Sulphur Co. Representatives of the investigating committee criticized severely the action of the Bureau of Internal Revenue in these cases. Since that time I have had the cases reexamined and wish to advise you as to the result of this reexamination in order that the facts disclosed thereby may be made a part of the record of the committee.

The greater part of the criticism by the representatives of the committee of the settlement of these cases was directed at the allowance by the bureau of a discovery value to the Texas Gulf Sulphur Co. and to the allowances of value for depletion purposes of the properties of these taxpayers.

With reference to the allowance to the Texas Gulf Sulphur Co. of discovery depletion, representatives of the committee stated "that the sulphur was discovered on the property of this taxpayer in 1903," and "that an engineer's report was made on this sulphur deposit in 1909 giving detailed information as to the existence of sulphur on the property, the thickness of the deposit, and other pertinent facts." The representatives of the committee stated that notwithstanding these facts the bureau allowed the taxpayer a discovery as of 1919 for depletion purposes. The real facts in connection with this matter, as shown by the data on file with the bureau, are these:

As early as 1903 and 1904 wildcatters, while drilling for oil on the property afterwards acquired by the Texas Gulf Sulphur Co., noticed some sulphur in the slush from the drilling. No attention was paid to it, however, at the time. Mr. Spencer C. Browne, a well-known mining engineer, who in 1910 made a careful examination of this claim of an earlier discovery of sulphur on the property, states:

"Following the discovery of the Spindletop oil dome near Beaumont, wildcat-drilling operations for oil were quickly started on most of the recognizable elevations on the Texas coast. A number of wells were drilled on the Matagorda big hill in 1903 and 1904, and until 1908 a small amount of oil was produced from moderately shallow wells near the higher part of the elevation. While drilling in some of the deeper of these oil wells crystals of sulphur were occasionally brought to be surface, but, on account of the peculiar porous character of the sulphur formation, the cuttings from the drill were usually lost in the fissures and not seen by the drillers. * * * The drillers were interested only in getting oil and the reports of the occurrence of sulphur carried no evidence of its thickness or extent or quantity."

This is the sole evidence of any discovery of sulphur on this property in 1903.

In 1903 Mr. J. M. Allen, of St. Louis, a promoter and not a mining engineer, in an attempt to financially interest other parties in this property because of the reports of the occurrence of sulphur in the oil wells on this property, got up a report in which he made extravagant claims as to the existence of sulphur on the property. This is the report that is referred to by the representatives of the committee as "an engineer's report" showing "the definite existence of sulphur on the property, the thickness of the deposit, and other pertinent facts." The facts are that Mr. Allen was not a mining engineer; that at the time he made these claims he was financially interested in the properties and was attempting to obtain financial support of his plans for development, and that not a single hole or well had been drilled in the property for the purpose of determining whether or not it contained sulphur, and that there were no reliable data, samples, or logs in existence showing that the property contained sulphur. In 1910 Mr. Allen, together with his associates, attempted to interest

Mr. S. W. Mudd, of Los Angeles, in this property, which they in the meantime had incorporated under the name of the Gulf Sulphur Co. Mr. Mudd sent Mr. Spencer C. Browne, a mining engineer, to examine the property for him and to ascertain whether a sulphur deposit had been discovered. In connection with this examination Mr. Mudd stated:

"In 1910, when I first got in touch with this Matagorda Big Hill property, I was not in the employ of the Gulf Sulphur Co. or the St. Louis interests. I was employed by Mr. S. W. Mudd, of Los Angeles, and clients of his who were desirous at the time of investigating sources of sulphur. My opinion of the Matagorda property after my investigation at that time was that it was an interesting prospect that might prove of great value but that the unsatisfactory character of the development to date had left it wholly unproven. I believed it worthy of further tests by drilling, if the property could be obtained on suitable terms, but would not have been greatly surprised if the drilling campaign (which began in 1917) had disproved the commercial value of the property."

This statement of Mr. Browne is substantiated by the correspondence between him and his client in 1910 which was filed with the bureau when this case was under consideration. For example, in a telegram it was stated:

"Matagorda long exploited in New York by J. W. Harrison. It was canvassed and considered undesirable by investigators. Pemberton thinks advisable to disregard Matagorda in proceeding with development. I coincide with these views."

In a letter written August 16, 1910, he says:

"No records from these oil wells are obtainable * * * On account of the unreliability of the interested and opposed parties I can not consider the discussion either favorable or otherwise * * * As an individual venture I should not recommend development of the Matagorda deposit."

As a result of these discouraging reports on the property (the first that had been made by any competent mining engineer), Mr. Mudd was not interested in it and no further steps toward its exploration seem to have been taken by anyone until some six years later.

In the spring of 1916 the parties who subsequently acquired the ownership of the Gulf Sulphur Co., now the Texas Gulf Sulphur Co., formed an association for the purpose of exploring the property. Beginning in September, 1917, these parties commenced and carried through a comprehensive and scientific drilling campaign to determine whether or not this property contained sulphur in commercial quantities. They employed competent engineers who made an exhaustive examination of the property. This exploration work was carried on from September, 1917, until the spring of 1918. The parties contributed some $625,000 for the purpose of carrying on this exploration work. As a result of this examination, and for the first time, it was determined that large deposits of sulphur existed in the property.

In view of the facts stated above, it is clear that the action of the department in allowing this taxpayer a discovery value for depletion purposes as of 1919 was proper.

With reference to the criticism made by representatives of the committee of the value placed on these properties by the bureau, it will be shown by discussion of the various elements entering into a valuation that if the values of the properties of the three companies are determined by thse use in each case of a risk rate of 10 per cent and 4 per cent as recommended by the committee, the results would be only slightly different from the values previously allowed by the bureau. In placing all of these companies on a basis of 10 per cent and 4 per cent, it has been necessary to adjust the life of each property and the net profit per ton. The Union Sulphur Co. was previously given a life of 20 years and an average profit of $15 per ton. There is no objection to the life of 20 years, but the $15 per ton appears to be too liberal to use with a risk rate of 10 per cent. Therefore the profit per ton has been adjusted to $11. This adjustment is necessary on account of the fact that the future expected annual production is only 300,000 tons and a reasonable estimate of cost would be $7, which, deducted from the reasonable estimate of selling price of $18, would leave $11 profit. The cost of producing sulphur by this company as of March 1, 1913, was approximately $6 per ton and a considerable portion of the deposit had been recovered. Subsidence of the surface had begun which would require filling at considerable cost. The engineers of this company have stated that the cost of production would increase toward the end of the operation until it approximated the selling price. There was a heavy stratum of quicksand above the deposit, which, owing to the subsidence of the deposit, would increase the difficulty of extraction. It is believed the cost should be taken at $7 per ton to properly account for the above factors.

The Union Sulphur Co. had raised to the surface and had in storage at March 1, 1913, approximately 600,000 tons of sulphur which, having become personal property, should have been carried in inventory and not valued for depletion. This leaves a net reserve of 5,400,000 tons. It is assumed that an estimated additional plant of $3,250,000 would be necessary and that the plant at March 1, 1913, would be valued at $3,250,000. In the case of the Freeport Texas Co. the estimate of the additional plant is changed to $2,500,000, the estimate of the plant necessary at March 1, 1913, to $1,000,000, and the profit to $10.08 per ton. In the case of the Texas Gulf Sulphur Co. operation is changed to 16 years instead of 12 as determined by the unit. This makes an annual production of 500,000 tons, which is sufficiently liberal under the conditions existing on the date of discovery. The profit also is increased from $9 a ton to $13 a ton, since on a production of 500,000 tons a year the costs would not be in excess of $5 on the average for the 16 years following the date of discovery.

The computations of the values of the three companies on this basis, with the above-mentioned changes, will be as follows:

	Union Sulphur Co.	Freeport Texas Co.	Texas Gulf Sulphur Co.
Ore reserve	5,400,000	3,459,000	8,000,000
Life	20	17	16
Profit	$11.00	$10.80	$13.00
Total profit	$59,400,000.00	$37,357,200.00	$104,000,000.00
Additional plant	3,250,000.00	2,500,000.00	5,000,000.00
Difference	56,150,000.00	34,857,200.00	99,000 000.00
Rate per cent	10.4	10.4	10.4
Factor	0.374302	0.413671	0.428610
Present worth	$21,017,057.00	$14,419,413.00	$42,432,390.00
Less plant estimate	3,250,000.00	1,000,000.00	5,000,000.00
Value	17,767,057.00	13,419,413.00	37,432,390.90
Allowed	16,838,423.00	13,775,857.00	38,920,000.00
Difference	928,634.00	356,544.00	1,487,610.00
Per cent of difference from value allowed	−5.5	+2.6	+3.82

It will be noted from the above computations that the greatest variance from the values previously allowed by the Income Tax Unit is only 5.5 per cent, a variance which is very slight in valuing properties of this character.

The next point to which the counsel for the committee objects is the allowance in invested capital of an original value of $3,000,000 in the case of the Union Sulphur Co.

After carefully considering all the evidence in the file, it is believed that the value of $3,000,000, as determined by the unit, has been adequately substantiated. As at acquisition on January 23, 1896, at least 500 tons of sulphur had been recovered by the Frasch process. More sulphur would have been recovered except for minor mechanical difficulties of pumping. The "air-lift" system of pumping was known to be operative for lifting water from great depth. Melted sulphur being lighter than water, could be pumped successfully by the system; in fact the installation of this system was in contemplation in the latter part of 1895. The success of the Frasch process was considered assured as at the date of acquisition of the property by the corporation.

Captain Lucas, an engineer and geologist of well known repute, has made an affidavit that the value of the sulphur in the ground was $1 per ton, or a total value for his estimate of the recoverable sulphur content of the deposit of $9,219,880.

Attention is further directed to the affidavit of Captain Lucas which states that the American Sulphur Co. had expended over $350,000 in development, and that prior to Mr. Frasch's success in 1896 it is estimated that considerably over $1,000,000 had been expended on the property.

The records show that in the opinion of various reputable engineers, the sulphur property was very valuable even before a suitable process for working the deposit was developed. The property was immensely more valuable after the development of the Frasch process, which was a definite success at the date the property was acquired.

Giving due consideration to Captain Lucas's opinion of the value of the property in 1896 and the opinions of other engineers that the property was one of great value, and considering the amount of money spent on the property, it is believed that the property had a value of not less than $3,000,000 as of January 23, 1896.

Another point referred to by representatives of the committee is the allowance of depletion to the parties who received 75 cents per ton as a consideration in the purchase of property by the Freeport Texas Co. Since the Solicitor of Internal Revenue has ruled that the transaction whereby the Freeport Texas Co. acquired the property was a purchase, then the 75 cents a ton subsequently paid represented deferred payments, and the vendors of the property in receiving such payments are receiving a return of capital, but are also receiving in part interest upon that capital. The actual cash value of the transaction on the date of sale is represented by the cash paid plus the present worth of the 75 cents per ton payments receivable in the future. The Income Tax Unit has determined that of the 75 cents received, 56.75 cents represented return of the principal and the balance represented interest and taxable income. The Income Tax Unit was incorrect in calling this allowance depletion, but the error was in name only and did not affect the tax liability of the parties involved.

In the light of the information disclosed by reexamination, it is believed that the action previously taken by the bureau in these cases is correct and that the cases should not now be reopened.

It is requested that this letter be embodied in the record of the committee as the reply of the Bureau of Internal Revenue to the criticisms made by the representatives of the committee.

Sincerely yours,

D. H. Blair, *Commissioner.*

Senate Committee Investigating Bureau of Internal Revenue,
Income Tax Unit,
July 23, 1925.

To: Mr. L. C. Manson, general counsel.
From: Mr. L. H. Parker, chief engineer.
Subject: Reply of bureau, sulphur cases.

We were much surprised to learn from the letter of Hon. D. H. Blair, commissioner to Hon. James Couzens, chairman of the Senate Committee Investigating the Bureau of Internal Revenue, under date of July 11, 1925, that the Commissioner of Internal Revenue had now given his approval to the plainly erroneous conception of what "discovery" means.

We had concluded that the commissioner did not uphold any such definition of discovery value as urged by certain tax experts, from the announcement made by Mr. Nash before the committee in the Penn Sand & Gravel Case, that this tax would be recomputed without benefit of discovery value.

The allowance of discovery value to the Texas Gulf Sulphur Co., which is now upheld in the letter of Commissioner Blair, above referred to, is along the same lines of argument used in the Penn Sand & Gravel Co. case, which he condemned after the Senate committee had brought this matter to his attention.

A comparison of these two cases is interesting.

In the Penn Sand & Gravel case we found that the presence of gravel was known in this territory since 1881, as proved by the report of Geologist Charles F. Hall in describing the geology of this country, although the exact extent thereof and commercial value was not determined.

In the Texas Gulf Sulphur case we find that the presence of sulphur was known in this locality in 1903, as admitted in the reports of Henry Krumb and Spencer C. Browne to the Texas Gulf Sulphur Co., although the exact extent thereof and commercial value was not determined.

In the Penn Sand & Gravel case, a well was excavated on the property and gravel shown to exist at a certain depth, an option was secured on the property by an individual in August, 1913, and the Penn Sand & Gravel Co. was incorporated in September, 1913. The property containing the gravel was purchased in October, 1913. The company claimed discovery value subsequent to October, 1913, on the basis that "it became a sand and gravel property only after exploration and development and then only after it was demonstrated that sand and gravel in quality and quantity sufficient to make it a valuable deposit were proven." The department allowed this claim finally, but reversed its action by order of the commissioner after the Senate committee had disclosed the facts.

In the Texas Gulf Sulphur case, sulphur was discovered on the property in 1903 when drilling for oil, its thickness was definitely recorded by R. O. Middlebrook in 1908 and 1909, and was further shown by six holes drilled by the Gulf Sulphur Co. in 1909 to 1910. The Gulf Sulphur Co. was incorporated in 1909 and its name changed to the Texas Gulf Sulphur Co. in 1918. The property containing the sulphur was purchased in 1909. The company claimed discovery value in 1919 on the basis that "little was known as to the quantity and grade of the ore until some time in 1918, and it was not known until March, 1919, when the steaming plant began to produce sulphur that the deposit could be worked at a profit." The Income Tax Unit allowed this discovery value, and it is now ratified by the letter of Commissioner Blair.

To sum up this phase of the case, the only interpretation we can put on the letter of the commissioner is that he holds discovery to take place only after all the following facts have been proven:

(1) Existence of ore body.
(2) Extent of ore body.
(3) Quality of ore body.
(4) Practical method of extracting ore.
(5) Proof that profit can be made in enterprise.

We submit that Congress used the word discovery in its usual sense and meant by this word nothing more or less than the act of finding out the existence of an ore body up to that time unknown. Of course, if the administrative branch of the Government can rewrite the meaning of the words in the english language, it does not make much difference what wording the legislative branch uses in the law.

The letter of the commissioner makes considerable capital of the point that your investigators called Mr. Allen a mining engineer. We stand corrected on this point. The fact of the matter is we do not care nor is it pertinent to know whether Mr. Allen was a mining engineer or not. The report of Mr. Allen made in April, 1909, is in the form of the ordinary field report by an engineer, and shows at least that he possessed the practical knowledge necessary along these lines; not only that, his predictions were fully justified by subsequent events and no reports of subsequent engineers attempt to pass the lie on his figures.

The statement of the bureau lays great stress on this statement, which they italicize (that at the time Mr. Allen made his investigation in 1909) *that not a single hole or well had been drilled in the property for the purpose of determining whether or not it contained sulphur and that there was no reliable data samples or logs in existence showing that the property contained sulphur.*

We can only put one construction on this statement, and that is that whoever prepared it for the commissioner is ignorant of the facts in the case or else is purposely trying to deceive the committee by concealing the main points at issue.

Stress is laid on the fact that the holes drilled were not drilled for the purpose of discovering sulphur. Is it possible that the bureau contends that in order to make a discovery it is necessary to have the intent to discover before the discovery is made? If a man drills a well for water and strikes oil, is it possible that he does not discover the oil, but must drill another hole with the intent of discovering oil before the discovery can be made?

The statement is made that no reliable logs were in existence at the time of Mr. Allen's report; we characterize this as a deliberate attempt to deceive the committee.

Here is a log shown in Mr. Allen's report which he actually saw being drilled:

WELL NO. 2

This is the well which was being drilled when I arrived, begun April 9, 1909, finished April 19, 1909; days actual drilling, 20.

Cost (approximately), exclusive of pipe, use of rig, and freight, $700.

Depth, 1,009 feet.

Log:	Feet.	Log—Continued.	Feet
Surface	18	Gumbo	109
Sand and shale	232	Rock and gypsum	8
Gumbo and shale	185	Medium soft sulphur	16
Gumbo	45	Gypsum and sulphur	3
Soft shale	20	Soft sulphur	8
Gumbo	50	Gypsum	1½
Water sand	15	Soft sulphur	2
Gumbo	35	Hard rock	1
Rock	4	Rock	½
Gumbo	6	Soft rock sulphur	14
Slate	90	Medium	8
Rock	3	Soft sulphur	7½
Hard shale	25		
Gumbo	102		1,009
Hard rock	6		

If the above is not a log what is it? There is also absolutely no evidence to show that it was not a reliable log, in fact subsequent drillings fully confirm the fact that it was a reliable log.

The italicized statement referred to, on which such stress is laid by making no mention of six holes drilled by the Gulf Sulphur Co. on this property in 1909–1910 for the purpose of exploring this sulphur deposit is obviously not in good faith. These holes fully determined the thickness of the deposit and showed at least some evidence of the quality of the deposit. The bureau must understand that the point we are criticizing is the allowance of a discovery value in 1919, and that it makes no difference whether this deposit was discovered in 1903, in 1908, or in 1910 as far as the results are concerned. The bureau is relying on an unsubstantiated statement of an engineer made for tax purposes that the samples were not reliably taken, when as a matter of fact records made at the time were fully proven by subsequent events to have been reliable.

Note that Mr. Browne, engineer, states in one of his reports also:

"In April, 1918, after completion of five wells, I reported a probable content of 3,982,000 tons of sulphur."

Yet the bureau says this deposit was not discovered until March, 1919.

Our opinion of this matter is that when the oil operators struck sulphur in 1903 and 1904 on this property, the deposit was at that time discovered within the meaning of the law for the existence of an ore body hitherto unknown was then uncovered, but it most certainly could not have been discovered after the evidence of the logs made in 1909 and 1910.

We will close this consideration of discovery by a hypothetical case which will show where the conception of discovery used by the bureau will lead us.

A ledge of limestone is in existence which has been known ever since man lived in the locality. The quality of the rock and exact volume had not been determined, hence the bureau would say it had not been discovered. In 1910 a cement company took samples of the rock, but found it too low in lime to operate at a profit, hence the bureau would say it had not been discovered. In 1918 a new method of making cement was invented which predicted the profitable use of this limestone; however, the bureau would not say the limestone was discovered. When the new plant is built in 1920 and the cement is actually manufactured at a profit then, and not till then, does the bureau admit that a discovery of the limestone deposit has been made. We believe no one can for a moment seriously maintain that Congress had any such intent as this when the discovery clause was put in the law.

The computations on page 5 of the commissioner's letter, which are supposed to justify the valuations made and allowed by bureau, are very interesting.

These figures prove for instance that if, in the Union Sulphur case, the valuation engineer had used a discount factor of 10 per cent and 4 per cent instead of 15 per cent and ore reserves of 5,400,000 tons instead of 6,000,000 tons and $11 profit per ton instead of $15 and allowed $3,250,000 for additional plant instead of not allowing at all for some, then the total value would have only been 5.5 per cent greater, which is insignificant. The valuations of the Freeport Texas Co. and the Texas Gulf Sulphur Co. are justified in a similar manner.

We have just one word to say on the above. The main object of our investigation was to determine the propriety of the methods used. We contend that gross errors in four principal factors of a valuation are not justified because they happen to compensate and the result checks another valuation within 5 per cent. If we go a step further we see that it is very easy to check almost any valuation by a judicious adjustment of the factors used in the analytic appraisal method.

In regard to the value of $3,000,000 allowed for invested capital to the Union Sulphur Co. in 1896, we still see no clear and substantial proof of this value, but nothing but opinion evidence. The fact remains that "The Union Sulphur Co. obtained control of these deposits January 23, 1896, the total consideration being $265,000, made up of $100,000 in stock and $165,000 in mortgage notes assumed by them"; we fail to see anything definite to prove that at this same date the property was worth $3,000,000.

The commissioner's letter brings out very clearly, in authoritative form, those principles the bureau contends for. As far as we are concerned, we are more convinced than ever that these principles violate the intent of the act and that Congress should be informed in what manner their revenue acts are being interpreted.

Respectfully submitted.

L. H. PARKER,
Chief Engineer.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, June 25, 1925.

Hon. JAMES COUZENS,
Chairman Senate Investigating Committee,
United States Senate.

MY DEAR SENATOR: Reference is made to the case of the Kerr Turbine Co., of Wellsville, N. Y., the income-tax settlement of which was criticized by the Senate investigating committee. The point in criticism in this case was directed toward the Income Tax Unit's action in allowing as salary deductions to the corporation for the years 1918, 1919, 1920, 1921, and 1922 the amounts of $36,253.18, $48,634.64, $34,372.69, $47,815.01, and $9,809.31, respectively, for the reason that the two officers to whose accounts the above amounts were credited only reported as income $31,103.61 for 1917, $6,300 for 1918, $4,500 for 1919, $6,027.56 for 1920, and $9,406.03 for 1921.

It is noted that when the salary items were credited on the corporation's books a restriction was inserted to the effect that the salaries were not to be paid until funds were available. The full amount credited for each year was allowed as a deduction to the corporation on its returns by the Income Tax Unit. Your committee is of the opinion that the deduction should not be allowed to the corporation until such time as the amount credited on the books of the corporation was paid to the individual or until such time as it was made available to the individual.

In connection with this case you are informed that a corporation may keep its books on the accrual basis, while an officer receiving a salary from such corporation may report on the receipts and disbursements basis. A case with exactly the same point involved, that of A. L. Englander was tested before the United States Tax Board. In the latter case, although the deduction was allowed to the corporation, the tax board, in its decision reported in bulletin 15, page 760, docket 602, stated that salary credited to an employee on the books of a corporation is not taxable income unless it is available for the use of such employee. The tax board in its findings of facts stated that the salaries in question were deducted on the returns of the corporation, and the tax board is apparently in accord with such deduction, inasmuch as no reference is made to the disallowance of such a deduction. Another case in which the board differentiated between the cash receipts and disbursements basis and the accrual basis is that of A. Bluthenthol, bulletin 3, page 173, docket 329.

In determining whether or not a salary deduction may be taken by a corporation the unit has resorted to two tests (1) whether it was properly authorized, paid, or accrued, and (2) whether it is reasonable and commensurate with the services rendered or is merely a dividend payment under the guise of salary. The United States Tax Board in passing upon practically all the salary cases appealed before that board has adopted the same tests employed by the unit. In the instant case no question has been raised as to the reasonableness of the salaries.

I am sure from the above you will understand that proper treatment was given the case of the Kerr Turbine Co. and the criticism made by your committee was due to the failure to take cognizance of the fact that a corporate entity and an individual receiving income from such corporation are not required to report income on the same basis. The corporation may report on the accrual basis, while the individual may report on the cash receipts and disbursements basis, and in addition does not have to report any income which is not made available for his use. It would seem, therefore, that no revision should be made in the adjustment of the Kerr Turbine Co.

Sincerely yours,

C. R. NASH,
Acting Commissioner.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, June 10, 1925.

Hon. JAMES COUZENS,
Washington, D. C.

DEAR SENATOR COUZENS: At the time the case of the Mellon National Bank of Pittsburgh was under discussion by the committee to investigate the Bureau of Internal Revenue, you requested to be advised as to what the practice of the bureau had been in regard to the affiliation for the year 1917 of national banks and trust companies. In the cases listed below the bureau has ruled as it did in the case of the Mellon National Bank that trust companies and national banks are not affiliated for the year 1917 for the reason that they are not engaged in the same or closely related business:

Hibernia Bank & Trust Co. (parent), Hibernia Safe Deposit Co., Hibernia National Bank, all of New Orleans, La. Ruling dated December 3, 1923.

First National Bank (parent), National Credit & Investment Co., both of Valley Falls, Kans. Ruling dated October 28, 1922.

First National Bank (parent), Security Loan & Guaranty Co., both of Seymour, Wis. Ruling dated June 19, 1920.

First National Bank of Estherville, Iowa (parent), Provident Savings Bank. Ruling dated December 13, 1922.

Modeste Bank (parent), Modeste Savings Bank, both of Modoste, Calif. Ruling dated November 24, 1924.

Farmers National Bank (parent), Stickney Investment Co., both of Longmont, Colo. Ruling dated October 22, 1922.

I shall appreciate it if you will have this letter embodied in the proceedings of the committee.

Sincerely yours,

D. H. BLAIR, *Commissioner.*

SENATE COMMITTEE INVESTIGATING
BUREAU OF INTERNAL REVENUE, INCOME TAX UNIT,
July 20, 1925.

To: Mr. L. C. Manson, general counsel
From: Geo. G. Box, chief auditor
Subject: Mellon National Bank and Kerr-Turbine Co.

The receipt is acknowledged of your memorandum of the 17th instant, transmitting copies of answers of the Commissioner of Internal Revenue in the Kerr-Turbine Co. and Mellon National Bank cases, on which you request my comments.

UNION TRUST CO., MELLON NATIONAL BANK, UNION SAVINGS BANK

It is noted that the committee was referred to several cases in which national banks were not affiliated with trust companies, safe-deposit companies, savings banks, etc. It is also noted that in all of the cases referred to in the commissioner's letter the decisions affected concerns in relatively small communities; or, in other words, no cases were cited affecting national banks, trust companies, and savings banks in any of the largest cities of the United States. This may have no significance, but I assume the same conditions as existed in the case of the Union Trust Co., Mellon National Bank, and Union Savings Bank in Pittsburgh existed in New York, Chicago, Philadelphia, and other large cities of the country.

In my opinion the decision arrived at by the Income Tax Unit that a national bank, a trust company, and a savings bank are not engaged in the same or a closely related business within the meaning of section 1331 of the revenue act of 1921 is ridiculous. It is strange, indeed, that a matter of such importance as the interpretation of this clause of the above-mentioned section was never decided by the solicitor or the committee on appeals and review. (This conclusion is reached from a search of published decisions.)

KERR-TURBINE CO.

From the examination of the returns of this concern it is very evident that the resolution of the board of directors which provided for the payment of commissions to the officers was for the purpose of taking advantage of deductions of the accrued commissions from its gross income and was framed in such language that the officers had no right enforceable at law to collect the same.

The resolution states that the commissions are to be drawn "only when in the opinion of the directors the financial condition of the company will permit." In other words, although the financial condition of the company was such that the commissions could be paid, yet if Merrill, the president, who dominated the corporation, did not desire to pay the commissions he could have withheld them as long as he held control.

Undoubtedly the resolution was passed for the purpose of accomplishing what the report shows it did accomplish, viz, to allow the corporation to deduct from its gross income large amounts representing accrued commissions which were never paid to its officers.

The answer of the commissioner does not explain the erroneous handling of this case.

GEO. G. BOX, *Chief Auditor.*

INVESTIGATION OF THE BUREAU OF INTERNAL REVENUE

JANUARY 7 (calendar day, JANUARY 12), 1926.—Ordered to be printed with illustrations

Mr. COUZENS, from the Select Committee on Investigation of the Bureau of Internal Revenue, submitted the following

PARTIAL REPORT

[Pursuant to S. Res. 168, 68th Cong.]

Under Senate Resolution 168, Sixty-eighth Congress, First Session, adopted March 12, 1924, your special committee was appointed and directed to investigate the Bureau of Internal Revenue and report its findings together with recommendations for corrective legislation.

This committee could not complete its work prior to the expiration of the Sixty-eighth Congress, and was authorized to continue its investigation after March 4, 1925, by Senate Resolution 333, Sixty-eighth Congress, second session, adopted February 26, 1925.

By the terms of Senate Resolution 333, this committee was required to withdraw its representatives from the offices of the Bureau of Internal Revenue and cease holding hearings on June 1, 1925, and was not permitted to withdraw any original papers from the bureau after that date. The only files or papers of the bureau which this committee or its agents have been permitted to examine since June 1, 1925, are such as were requested prior to May 15, 1925.

The above mentioned limitations upon the authority of this committee have prevented the investigation of many subjects and cases which would have been investigated but for such limitations.

HISTORY AND SCOPE OF INVESTIGATION

This committee first held hearings from March 14, 1924, to April 9, 1924. It became apparent that the nature of the work of the Bureau of Internal Revenue, particularly the work of the Income Tax Unit, is such that no satisfactory investigation could be conducted without legal, engineering, accounting, and clerical assistants. The employment of such assistants was authorized by Senate Resolution 211, adopted April 22, 1924.

The organization of a staff of assistants, under Resolution 211, was commenced in August, 1924. Hearings were resumed on November 20, 1924, and were held almost continuously until June 1, 1925. Since June 1, 1925, the staff of the committee has been engaged in the examination of copies of records called for prior to May 15, 1925, and in the preparation of data for the committee's report.

Three general lines of investigation have been pursued by this committee.

1. The administration of the prohibition laws have been investigated. A separate report will be made upon the investigation of prohibition.

2. A statistical investigation has been made to ascertain the cause of the marked year to year variation in taxable income, particularly in the high-tax brackets, and the extent to which income is escaping tax. The results of this investigation will be the subject of a separate report.

3. The administration of the income and estates tax has been investigated. The attention of the committee was especially directed to the fact that large mining, oil, and manufacturing corporations were escaping taxation through tremendous deductions for depletion and the amortization of war facilities. These abuses, having been called to the attention of the committee during its early hearings, became the first subjects of inquiry by the committee's staff.

The subjects of amortization of war facilities, depletion, the valuation of natural resources for depletion and invested capital purposes, compromises, organization, and procedure have been thoroughly investigated. Considerable information has been obtained on publicity of rulings, invested capital, special assessments, depreciation, deduction of losses and taxation of capital gains. Many subjects within the jurisdiction of the audit divisions have not been covered because of the termination of our authority.

This report covers the results of our investigation of the administration of the income tax upon those subjects which this committee believes require the immediate attention of Congress. This report will be supplemented by a subsequent report on income and estates tax administration.

In addition to a statement of the facts, our conclusions and the reasons therefor, this report contains various suggestions for remedial legislation. As four of the five members of this committee are also members of the finance committee, which will doubtless consider this same subject matter, it is not deemed advisable that this committee finally commit itself to any definite legislative proposals. The recommendations for remedial legisilation, contained in this report, are therefore to be considered as recommendations, which this committee considers worthy of serious consideration by the finance committee and by the Congress.

Summary of Findings

The findings of this committee upon the subjects covered by this report, may be briefly summarized as follows:

DISCOVERY DEPLETION

Discovery depletion is an exemption from taxation upon realized increment in value; not enjoyed by other taxpayers. Upon a tax rate of 12½ per cent; this exemption to the oil industry alone amounts to approximately $37,500,000 annually, and during the high-tax period it was correspondingly greater. But a minor part of this exemption is received by the wildcatter or prospector for whose benefit it was intended. The major portion of this exemption goes to the large oil-producing companies, which also deduct the prospecting and developing expense, intended to be offset by discovery depletion, from income as operating expense.

The regulations governing discovery depletion do not confine this exemption to the discovery of new deposits, but permit the blanketing of known pools of oil with discovery values, to be depleted, free of tax.

The statutory limitation of the value to be depleted, to that evident on the date of discovery or within 30 days thereafter, is ignored by the Commissioner of Internal Revenue, and indefinite periods of time are allowed, within which to fully develop values, to be deducted from taxable income as discovery depletion.

It is very clear that the purpose of the provision for discovery depletion was to stimulate prospecting for new deposits of mineral and oil, yet the allowance of discovery depletion is not confined to the taxpayers who discover new deposits of mineral or oil, nor to deposits discovered since March 1, 1913, but is allowed to taxpayers who develop discoveries made by others, and upon deposits known to exist prior to March 1, 1913.

DEPLETION OF VALUES DETERMINED BY ANALYTIC APPRAISALS

Analytic appraisals, which determine values to be depleted by discounting estimated expected profits, are too elastic and leave too much to the judgment of individual engineers to be suitable for taxation purposes. An amendment of the law is required to permit the substitution of a more suitable method. A substitute method is described herein.

There has been a growing tendency, on the part of authorities in the Bureau of Internal Revenue superior to the engineering valuation sections, to set aside sound determinations of values to be depleted, and to substitute excessive values, based upon analytic appraisals, in which the value of manufacturing and sales profits are attributed to ores in the ground. This practice is forbidden by the regulations, but the regulations are being so generally ignored, in this respect, that an amendment to the law is considered necessary to prevent further discrimination.

The valuation engineers of the Income Tax Unit have found that tentative valuations of copper and silver mines were grossly excessive, due to the use of excessive estimates of prospective profits, to the use of inadequate discount rates, and to plain mathematical errors in analytic appraisals. The erroneous valuations of copper mines have been corrected, as to 1919 and subsequent years, but have been permitted to stand for the years of 1917 and 1918. The Commissioner of Internal Revenue has refused to permit the correction of errors found to be common to all the silver mine valuations. The loss of tax due to these erroneous valuations is estimated to be approximately $60,000,000.

ADMINISTRATION OF DEPLETION

In the valuation of oil properties there appears to be no system, no adherence to principle, and a total absence of competent supervision. Numerous cases were called to the attention of the committee in which values, varying by more than 100 per cent, are made the basis of depletion allowances to the owners of undivided interests in the same oil property.

The practice of setting aside valuations, made by valuation engineers, without giving them an opportunity to be heard, has lead to highly discriminatory, and in some cases, absurd results.

Precedents established by such rulings have had a marked tendency to disorganize the work of the valuation sections and make it difficult to keep valuation work on a sound basis.

So little supervision has been exercised by the Commissioner of Internal Revenue over valuation work, and the procedure in force renders it so difficult for the chiefs of valuation sections, directly responsible for this work, to communicate with the commissioner, that practically all discretion as to valuations, vested by law in the commissioner, has in fact been exercised by the head of the engineering division.

Mr. S. M. Greenidge has been the head of the engineering division of the Income Tax Unit during the most of the period covered by this investigation. Mr. Greenidge appears to be ill informed as to the work under his jurisdiction, incompetent, and generally unfit for any position in the Government service requiring the exercise of engineering ability and sound discretion.

There appears to be a growing tendency by authorities superior to the appraisal section chiefs to make a production record regardless of principle and to give persistent and influential taxpayers anything required to reach a settlement.

AMORTIZATION OF WAR FACILITIES

The allowance of tax-free deductions from income, for the amortization of the war facilities of manufacturers and miners, is a subject which demands the immediate attention of Congress.

The magnitude of this subject is shown by the following figures:

	Number of claims	Total amount
Amortization allowances to Apr. 30, 1925	3,334	$596,934,813.26
Amortization claims pending but not acted upon on Apr. 25, 1925	178	75,171,169.87
Total	3,512	672,105,983.13

All amortization allowances exceeding $500,000 have been reviewed by the committee's staff and improper allowances in this class alone appear to amount to $210,665,360.40. The tax on about two-thirds of this amount can be saved to the Government by prompt action of Congress.

Notwithstanding the tremendous amounts involved, the regulations have contained no adequate statements of the principles to be observed in determining amortization allowances. No ruling or instructions for the guidance of either the engineers of the Income Tax Unit, or taxpayers, were published until after the expiration of the time fixed by law for the redetermination of claims. The only published ruling of the solicitor on this subject, prior to October, 1925, has been completely ignored, and there has been a total lack of supervision over the work of the engineers of the Income Tax Unit engaged in passing on amortization claims.

The failure to observe any well-defined principles, as to either the kind of property, the cost of which is amortizable, or in measuring the allowance, has resulted in the grossest kind of discrimination among taxpayers.

The improper amortization allowances are principally upon facilities, which have been retained in postwar use by taxpayers, and in many cases such allowances are in addition to allowances covering all loss due to reduced postwar replacement value.

These allowances are predicated upon the assumption that all manufacturing capacity, above the average requirements of 1921, 1922, and 1923, but required to meet the irregularity of month-to-month and year-to-year demand, required to participate in the profits of the years when demand is greatest and profits are highest, required to replace older facilities as they wear out, and required to meet the expansion of a growing business, represents a total, permanent, capital loss properly attributable to the war years.

In many cases amortization has been allowed on the theory that manufacturing capacity, created by war expenditures, constituted a useless surplus, notwithstanding the fact that the taxpayer had increased his war capacity by postwar expenditures. Postwar expenditures, to increase capacity held to be a useless surplus, have, in all cases, been ignored.

While the purpose of the amortization provision was to encourage the acquisition of facilities for the production of war necessities, a large part of the allowances are upon facilities acquired by contract entered into before April 6, 1917.

Amortization has also been allowed on pre-war facilities, in full operation on April 6, 1917, because they were transferred from a corporation to its subsidiary or by a group of corporations to a consolidation without any real change of ownership or increase of capacity for war production.

There has been gross discrimination in arbitrarily allowing amortization for reduced postwar cost of replacement in some cases and in denying it in others similarly situated, in allowing amortization to some transportation companies, while it is generally denied others, and in allowing amortization on land.

The committee was furnished a list of all amortization allowances passed by the amortization engineers of the Income Tax Unit to and including April 30, 1925. Thre engineers' reports on all cases in which the total allowance exceeded $500,000 have been examined by the committee's staff. A statement of the amounts involved in each of these cases is appended at the end of this section of their report.

COMPROMISE OF TAXES AND PENALTIES

It has been the consistent policy of the Commissioner of Internal Revenue to exceed the authority delegated to compromise taxes. The commissioner, in compromising taxes, has followed the policy of giving the unsecured creditors and stockholders of insolvent corporations precedence over the Government's claim for taxes.

As administered by the Commissioner of Internal Revenue, the fraud penalty fixed by Congress is never enforced, but is treated as a maximum penalty.

REFUNDS, CREDITS, AND ABATEMENTS

Tax refunds amounting to $459,090,825 were made by the Bureau of Internal Revenue from July 1, 1921, to April 30, 1925.

The refunds, credits, and abatements exceeding $250,000 aggregate $171,546,416.59. An analysis, based upon the ground of allowance, is given in this report. This analysis shows that the two principal grounds for these allowances are increased allowances for invested capital and taxing by special assessments. These two grounds account for $73,842,115.35, or 43.04 per cent of all the refunds, credits, and abatements exceeding $250,000.

A list of refunds, credits, and abatements exceeding $1,000,000, which aggregate $85,929,697.99, is contained in this report at page 195.

INVESTED CAPITAL AND SPECIAL ASSESSMENTS

Invested capital was the basis of the war profits and excess profits taxes. The special assessment provisions of the law provided for the determination of the tax, by comparison with the tax paid by representative concerns in the same industry, in cases where invested capital could not be determined or where the taxpayer suffered a special hardship by abnormality in income or invested capital.

While these subjects do not apply to taxes now being imposed, they are of present importance as the principal basis of enormous refunds, credits, and abatements. The limitation upon the authority of this committee did not permit a thorough investigation of these subjects. Such investigation of these subjects as was made showed that it is the consistent policy of the Bureau of Internal Revenue to ignore the limitations upon invested capital and the application of special assessment contained in the 1917 act, and that, in the administration of the 1918 and subsequent acts, most unsound practices are being generally followed.

The principal administrative difficulties incident to invested capital and special assessment are due to the failure to observe the plain provisions of the law.

DIVISION HEADS SUPREME

The practically unlimited discretionary power vested in the Commissioner of Internal Revenue is actually exercised by the division heads. These division heads are governed by no adequate rules or instructions, and unless a taxpayer is dissatisfied with the determination of his tax, or unless a refund exceeding $50,000 is involved, there is no review of the work done under a division head.

Under the procedure of the Bureau of Internal Revenue there is no way for any tax determination which is satisfactory to the taxpayer and which does not involve a refund of $50,000 or more to be brought to the attention of the Commissioner of Internal Revenue or any other superior of a division head, except by the protest or complaint of a subordinate of such division head.

All communications from subordinates of division heads to superiors of division heads are forwarded through the division heads. Communications from section chiefs to the commissioner and solicitor relating to official business have been suppressed. It is the policy of the income tax unit to discourage complaints and protests by subordinates. This policy leaves the division heads supreme and their superiors in ignorance of how the law is really administered.

PUBLICITY OF PRINCIPLES AND PRACTICES

Many of the principles, practices, methods, and formulas applied in the determination of tax have never been reduced to writing, and only 15½ per cent of the formal written rulings applicable to income taxes have been published.

This failure to promulgate and publish the principles and practices to be followed in the determination of tax liability has had the following results:

1. Information for the guidance of the employees of the income tax unit is so incomplete that gross discrimination results from the failure to apply uniform principles to similar cases.

2. Taxpayers, in many instances, have failed to claim allowances granted others similarly situated.

3. To secure the benefit of unpublished precedents, taxpayers are forced to employ former employees of the income tax unit to advise and represent them in tax cases.

4. Their exclusive possession of information as to the unpublished precedents and practices of the income tax unit has placed an artificial premium upon the value of the services of ex-employees which enables them to demand and receive immense fees for information which should be freely available to everybody.

5. This artificial premium, thus placed upon the exclusive information possessed by the employees of the Income Tax Unit, and the opportunity thus afforded for highly lucrative outside employment, is the cause of the extraordinary turnover among the employees of the unit and of the difficulty experienced by the unit in retaining the services of competent employees at salaries within the range of the salaries paid by the Government for comparable service.

6. The failure to consider closed cases as precedents and to publish the principles and practices followed in closed cases as precedents has deterred the formation of a body of settled law and practice. The unsettled state of the law and practice has encouraged the filing of claims for allowances and require the constant rediscussion and reconsideration of questions, which should be settled by precedents established by closed cases.

7. The fact that a ruling will be published, and the benefit of its principles claimed by taxpayers similarly situated, is the strongest possible deterrent against making unsound rulings.

8. During the course of the hearings there has been a great deal of evidence tending to show that it is the policy of the bureau to fix taxes by bargain rather than by principle. Rulings based upon bargains can not be published as precedents. The best and most persistent trader gets the lowest tax and gross discrimination is the inevitable result of such a policy.

PUBLICITY OF RECORDS

The unsatisfactory conditions developed by this investigation are the inevitable result of the delegation of almost unlimited discretion to be secretly exercised. It is believed that but few of the unsound settlements to which attention has been called would have been made if it were not for the belief that they would never become public.

While the objections to throwing the records of the Income Tax Unit open to the public are recognized, the necessity for the opportunity for some outside scrutiny is imperative.

Congress in imposing a system of taxation the administration of which necessarily involves the exercise of so much discretion assumes some duty to the public to see that such discretion is not abused.

CAUSES OF DELAY IN DISPOSAL OF CASES

This investigation discloses that the principal causes of the delay in the disposal of old cases may be stated as follows:

1. Bargaining with taxpayers instead of assessing taxes in accordance with published precedents.
2. Innumerable conferences incident to the bargaining policy.
3. Granting innumerable extensions of time for furnishing information required to determine the validity of deductions.

Depletion and Valuation of Natural Resources for Depletion and Invested Capital Purposes

The determination of proper allowances, as deductions from taxable income, to cover the depletion of mines, oil and gas wells, and other natural deposits is one of the most important as well as one of the most troublesome questions involved in administering the income tax law.

The importance of the matter of depletion allowances is shown by a comparison of the net taxable incomes of taxpayers in the mining and oil industries, with the depletion allowed as tax-free deductions from income. No statistics of depletion and other deductions are prepared by the Bureau of Internal Revenue, but from the several sources hereinafter stated statistics have been prepared reflecting the effect of depletion allowances upon net income and the importance of the determination of such allowances upon a proper basis.

SPECIAL EXAMPLES OF DEPLETION

The enormous deductions either allowed or claimed in certain cases are astounding and bring out more clearly than any argument the need of proper regulation of this matter. The figures speak for themselves and will be given in three groups as in the case of our general statistics, inasmuch as they are taken from the same three sources.

Individual cases of depletion

AS FOUND ON SPECIAL ASSESSMENT RECORDS

Industry	Year	Taxable net income	Depletion	Per cent of depletion to net income
OIL PRODUCERS				
Humble Oil & Refining Co.	1918	$1,196,961	$3,556,505	297.13
Magnolia Petroleum Co.	1918	9,056,576	15,040,724	166.08
South Penn Oil Co.	1919	2,289,141	2,166,621	94.65
McMark Oil & Gas Co.	1919	227,060	993,015	437.34
Gilliland Oil Co.	1920	1,538,697	3,283,656	213.40
COPPER MINES				
Calumet & Hecla Mining Co.	1918	3,713,297	1,701,756	45.83
Mohawk Mining Co.	1919	416,042	426,981	102.63
IRON MINES				
Wakefield Iron Co.	1918	625,026	574,036	91.84

FROM FIGURES SUPPLIED BY THE ASSISTANT COMMISSIONER

Industry	Year	Taxable net income	Depletion	Per cent of depletion to net income
COPPER MINES				
Chino Copper Co.	1918	$2,963,539	$3,667,904	123.77
Kennecott Copper Co.	1918	8,221,218	8,522,524	103.67
Nevada Consolidated Copper Co.	1918	155,298	4,385,200	2,823.73
Utah Copper Co.	1918	9,807,735	10,304,919	105.07
Chino Copper Co.	1919	142,828	1,277,985	894.77
Inspiration Consolidated Copper Co.	1919	1,506,155	2,208,323	146.62
Magma Copper Co.	1919	122,041	466,624	382.35
Phelps-Dodge Corporation	1919	2,835,888	3,800,225	134.00
Utah Copper Co.	1919	2,716,051	3,565,660	131.28
Miami Copper Co.	1920	962,324	1,807,483	187.82
SILVER MINES				
Cinco Minas Co.	1917	177,988	447,532	251.44
Do	1918	276,519	470,759	170.24
Alvarado Mining & Milling Co.	1918	102,870	377,883	367.34
Nevada Wonder Mining Co.	1918	82,284	193,678	235.35
New York Honduras Rosario Mining Co.	1918	72,646	324,750	477.03
Tintic Standard Mining Co.	1918	151,177	317,169	209.86
Cinco Minas Co.	1919	51,205	658,014	1,285.00
ZINC MINES				
Butte & Superior Mining Co.	1917	449,337	1,674,569	372.68
Northern Ore Co.	1917	94,661	195,484	206.51
Butte Copper & Zinc Co.	1918	92,503	518,285	560.29
Golden Rod Mining & Smelting Co.	1918	11,994	811,648	6,767.12
Montreal Mining Co.	1918	55,197	250,859	454.48
Oklahoma Woodchuck Zinc Lead Co.	1919	104,911	174,830	166.65
Underwriters Land Co.	1919	57,951	125,838	217.15
LEAD MINES				
Caledonia Mining Co.	1917	467,593	736,660	157.54
Hecla Mining Co.	1917	952,874	1,147,331	120.41
Hercules Mining Co.	1917	1,141,368	2,642,977	231.56
Hecla Mining Co.	1918	1,061,746	1,119,133	105.40
Hercules Mining Co.	1918	429,463	1,662,771	387.17
Caledonia Mining Co.	1920	91,095	156,804	172.13
Hecla Mining Co.	1920	144,921	508,459	350.85
Hercules Mining Co.	1920	241,965	968,056	400.08
IRON MINES				
Port Henry Iron Ore Co.	1918	96,528	134,496	139.33
Witherbee Sherman Co.	1917	70,615	893,745	1,265.66
Verona Mining Co.	1918	57,059	511,442	896.34
Witherbee Sherman Co.	1918	174,594	635,759	364.14
Port Henry Iron Ore Co.	1919	67,404	144,751	214.75
Verona Mining Co.	1919	282,452	421,512	149.23
Port Henry Iron Ore Co.	1920	85,196	140,105	164.45
Verona Mining Co.	1920	312,865	438,870	140.27
Witherbee Sherman Co.	1920	75,371	656,858	871.50

Individual cases of depletion—Continued

FROM FIGURES SUPPLIED BY THE ASSISTANT COMMISSIONER—Continued

Industry	Year	Taxable net income	Depletion	Per cent of depletion to net income
OIL PRODUCERS				
Gulf Oil Corporation and subsidiaries	1918	$7,817,988	$13,906,112	177.87
Cosden & Co	1919	2,353,015	2,533,278	107.66
Gulf Oil Corporation and subsidiaries	1919	3,300,381	14,807,423	448.66
Humble Oil & Refining Co	1920	5,712,709	5,953,634	104.22
Gilliland Oil Co	1920	1,539,698	3,262,657	211.90

INDIVIDUAL CASES OF DEPLETION AS CLAIMED BY TAXPAYER ON 1923 TAX RETURNS

Industry	Taxable net income	Depletion	Per cent of depletion to net income
OIL AND GAS PRODUCERS			
Union Oil & Gas Co	$94,026	$899,933	957.11
Goodwin-Barclay Co	87,607	106,806	121.91
Godfrey L. Cabot	86,644	314,588	363.08
Lewis Oil Co	66,263	303,116	457.44
Cliff Petroleum Co	72,938	288,995	396.22
Oil State Petroleum Co	133,695	290,713	217.44
IRON MINES			
Wysox Iron Co	67,861	78,026	114.98
ZINC MINES			
Commerce Mines & Royalty	677,177	954,800	141.00
COPPER MINES			
Utah Copper Co	1,114,110	6,621,199	594.30
TIMBER COMPANIES			
Scarboro Safrit Lumber Co	53,346	70,008	131.23
Lendinghaus Lumber Co	55,715	148,084	265.79
Blackwood Lumber Co	71,705	97,191	135.54

When it is considered that depletion is a book deduction oftentimes on a fictitious discovery valuation, or a value as of date of organization based on a stock transfer, then the above figures must show of themselves the very great importance of this matter of depletion at the present time, as well as in old tax cases.

This committee has made an extensive investigation of the operation and administration of the provision of the law providing for deductions from income for the depletion of oil and gas wells, mines, and other natural deposits.

Statutory Provisions

The 1913 and subsequent acts taxing incomes recognize the fact that the capital invested in mineral oil and gas and other natural deposits and in the standing timber is consumed in the operation of recovering and selling such natural resources as merchantable products. To determine the net profit derived from such property to be taxed as net income the law therefore makes provision for the deduction of a reasonable allowance for depletion.

The revenue act of 1924 provides as follows:

SEC. 214 (a). In computing net income there shall be allowed as deductions: (9) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions of each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the commissioner, with the approval of the Secretary. In the case of leases the deduction allowed by this paragraph shall be equitably apportioned between the lessor and lessee.

The basis for determining the amount which is to be depleted is provided in section 204 of the revenue act of 1924, which provided as follows:

SEC. 204 (c). The basis upon which depletion * * * are to be allowed in respect to any property shall be the same as is provided in subdivision (a) or (b) for the purpose of determining the gain or loss upon the sale or other disposition of such property, except that in the case of mines, oil and gas wells, discovered by the taxpayer after February 28, 1913, and not acquired as the result of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost, the basis for depletion shall be the fair market value of the property at the date of discovery or within thirty days thereafter; but such depletion allowance based upon discovery value shall not exceed 50 per centum of the net income (computed without allowance for depletion) from the property upon which discovery was made, except that in no case shall the depletion allowance be less than it would be if computed without reference to discovery value.

The provisions of subdivisions (a) and (b) cover property acquired by purchase, gift, exchange, and by transfers in trust. For the present purpose, it is only necessary to consider the basis used in determining the depletion allowance for property acquired prior to March 1, 1913, and for property acquired by purchase since February 28, 1913.

1. In cases where discovery depletion is not allowable, and the property to be depleted was acquired prior to March 1, 1913, section 204 (b) provides that the basis for determining depletion shall be either the cost of such property, or its "fair market value" on March 1, 1913, whichever is greater.

2. In cases where discovery depletion is not allowable, and the property to be depleted was purchased subsequent to February 28, 1913, section 204 (a) provides that the basis for determining depletion shall be the cost of the property.

3. In cases where discovery depletion is allowable, the basis for determining depletion is the fair market value on the date of discovery, or within 30 days thereafter.

SPREAD OF DEPLETION

The cost or market value, as the case may be, as of the basic date applicable to the case, is divided by the number of recoverable units of mineral, oil, timber, or other deposited material, estimated to be within or upon the property on the basic date, to determine the depletion unit. This depletion unit is multiplied by the number of units sold or produced during each year, to determine the depletion sustained during that year. The capital sum to be depleted is reduced each year by the depletion sustained.

In case of capital additions subsequent to the basic date, the cost of such additions is added to the capital sum to be depleted, and the estimated units in any acquisitions are added to the estimated remaining units in the original deposit. The increased capital sum is then divided by the increased estimated units, to determine a new depletion unit.

The depletion allowable, as a deduction from the income of any year, is the depletion sustained during that year, except in the case of discovery depletion, the deduction, under the 1924 act, can not exceed 50 per cent of the net income computed without regard to depletion.

When the depletion sustained equals the value set up as subject to depletion, no further depletion is allowable as a deduction from income.

As is shown in the discussion of the United States Graphite Co. and the Celite Products Co. cases, at page 60 hereof, the alternative basis, provided by article 211 of Regulations 65 for determining the depletion deduction by multiplying the depletion unit "by the number of units sold or produced within the taxable year" leads to contradictory results.

The determination of depletion allowances is a function of the engineering division of the Income Tax Unit. This work during the period covered by the investigation was divided among five sections of the engineering division, each of which is in charge of a section chief.

Depletion allowances for metal mines, such as silver, copper, lead, zinc, iron, etc., are determined by the metals valuation section, of which Mr. John Alden Grimes is chief.

Depletion allowances for coal mines are determined by the coal valuation section, of which Mr. R. C. Davis is chief.

Depletion allowances for timber are made by the timber valuation section, of which Mr. E. B. Tanner is chief.

Depletion allowances for nonmetal deposits, such as sand, gravel, stone, clay, graphite, phosphate, etc., were determined by the nonmetals valuation section, of which Mr. J. H. Briggs was chief until the consolidation of that section with the metals valuation section under Mr. Grimes.

Depletion allowances for oil and gas wells are determined by the oil and gas valuation section, of which Mr. W. W. Thayer was chief until he recently resigned.

The work of all of these sections comes under the jurisdiction of the head of the engineering division. Mr. S. M. Greenidge was head of the engineering division during the most of the period covered by this investigation, and Mr. C. C. Griggs was assistant to Mr. Greenidge.

Neither this committee nor its staff have found anything to criticize in the work done under Mr. Grimes, Mr. Davis, Mr. Tanner, or Mr. Griggs. In so far as the work done by these section chiefs and the engineers under them has not been interfered with by their superiors, it is found to be in accordance with sound principles.

Several cases have been called to the attention of the committee, in which these sections have been overruled, and determinations made which are not only unsound and discriminatory, but which, as precedents, will prove troublesome, as tending to upset the sound principles which have been observed in these sections.

NEW ENGLAND LIME COMPANY

The determination of depletion in this case, made by Mr. C. C. Griggs, assistant head of the Engineering Division, over the protest of Mr. J. H. Briggs, who was assistant chief of the nonmetals section when this case was settled, violates every provision of the law and regulations and every principle governing depletion allowances.

The property in question consists of stone quarries, acquired prior to March 1, 1913. No valuation was made for depletion purposes. This taxpayer was given a flat deduction of 6 cents per ton depletion, on the theory that this would amount to about 1 per cent of the income. As depletion is not based upon any value to be depleted, this allowance will go on for all time until the property is exhausted.

While the settlement made with this taxpayer allowed it to deduct depletion from income, on the theory that the stone quarried and sold consumed 1913 capital, this settlement also provided that the invested capital of the taxpayer should not be reduced by the depletion allowed as deduction from income. Thus for income purposes, the capital was considered to be reduced by current operations, but for invested capital purposes, the capital was considered to be unaffected by operations.

UNITED VERDE EXTENSION MINING CO.

(3187–3196, 3406–3499)

Under a final agreement under section 1312, entered into by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, on January 24, 1924, this company was allowed illegal deductions from its 1917 income amounting to $2,762,284.97, which relieved it of an additional assessment for 1917 of $721,260.82.

This action was taken upon the recommendation of Mr. Bright, Deputy Commissioner of Internal Revenue, in charge of the Income Tax Unit, and Mr. Greenidge, head of the engineering division. At the time Mr. Bright and Mr. Greenidge recommended this action, they were fully informed as to all the facts in the case.

The illegal deduction, above referred to, consisted of an excessive allowance for depletion of $2,265,756.33, an allowance for development cost, which should have been capitalized and returned through subsequent depletion of $461,407.50, and two other items amounting to $35,121.14.

The United Verde Extension Mining Co. was organized in June, 1912, with an authorized capital of $750,000, consisting of 1,500,000 shares of the par value of 50 cents per share. The property was acquired during June, 1921, in exchange for 1,050,000 shares of the capital stock. The sale of 450,000 shares of the stock at this time at 50 cents fixed the value of the stock at par. On this basis the cost of this property was determined by the engineers of the Income Tax Unit to be $525,000.

When this property was acquired by this taxpayer, it was a mere prospect, in which exploration work had been going on since 1888, in the hope of finding an extension of the ore body of the United Verde mine, which adjoined it. Exploration work was continued by the taxpayer until 1915, when an immensely rich ore body was discovered. Between the acquisition of the property in June, 1912, and the discovery of the mineral in 1915, nothing developed which could effect the value of this property.

For 1915 and 1916 depletion was based upon the cost of $525,000. In its return for 1917 this taxpayer claimed a deduction of $461,407.50, as its development costs up to that time, and depletion amounting to $2,301,296.48. This return was filed in March, 1918. It was not until the fall of 1919 that a valuation force was organized in the Bureau of Internal Revenue, and in June, 1918, a tentative assessment of a tax of $2,123,809.55 was made by the tax advisory board. This tentative assessment was based upon the net income as reported by the taxpayer.

In November, 1919, when the Bureau of Internal Revenue undertook to examine depletion claims, this taxpayer was called upon to furnish information to substantiate its depletion deductions. On November 25, 1919, the taxpayer formally claimed a depletable value, as of March 1, 1913, of $40,000,000 on 2,000,000 tons. As the ore was not discovered until 1915, there was no ore value in sight on March 1, 1913. The taxpayer evidently recognized this fact, because on June 7, 1918, it filed a claim for a depletable value of $40,000,000, based on discovery value as of December 31, 1916, of $39,546,137.50 and development cost of $453,562.40.

On February 25, 1919, discovery value, to be depleted in 1918 and subsequent years, was allowed at $30,652,379, and depletion was allowed on cost of $525,000 for 1916 and 1917.

The result of this action was to reduce the deductions, and increase the 1917 income of this taxpayer by $2,762,284.97, and on January 24, 1923, the taxpayer was notified of an additional assessment of $721,260.82. On January 24, 1924, the agreement above referred to closed this case on the basis of the tax paid and cancelled the additional assessment.

The effect of this action was to allow deductions for 1917 for depletion of $2,301,296.48 and development costs of $461,407.50.

The development costs represented capital expenditure over a period of several years, and should have been capitalized and returned as depletion over the life of the mine.

There is no basis whatever for this allowance of over $2,300,000 for depletion for 1917. As the provision for the depletion of discovery values did not become effective until 1918, there was no legal basis for depletion except cost of March 1, 1913, value. Depletion based on cost would amount to $35,540.15, and nothing had occurred between the date of acquisition and March 1, 1913, to increase the value as of March 1, 1913, over cost.

In his testimony before the committee with reference to this case, Mr. Bright admitted that there was no basis whatever for the allowance of this depletion (3187–3196). He tried to justify the closing of this case on the ground that, if this depletion had been disallowed, the taxpayer might have received a lower tax rate under a special assessment, but he acknowledged that under the lowest rate he could apply, there was still over $150,000 due the Government, when this taxpayer was released in full (3192).

BORDER ISLAND CO.

The Border Island Co. case (1433) involves an allowance for the depletion of a deposit of sand and gravel located in the Niagara River, near Buffalo. This case was settled in the solicitor's office on appeal from the action of the nonmetals valuation section. In attempted justification of the use of a very low discount factor, the engineer who handled the case in the solicitor's office stated to the committee that the taxpayer claimed that the deposit was being constantly added to by natural accretion (1459). Such accretions would tend to reduce the depletion due to the removal of the deposit, and if the accretions of sand and gravel equaled the amount removed there would be no depletion of capital whatever. No investigation of the extent of the accretions was made.

In determining depletion the solicitor's office gave no consideration to the effect of these accretions, except to increase the value to be depleted by the use of a lower discount factor, in discounting anticipated profits to a present value. This resulted in increasing instead of reducing the depletion allowance. Thus, in this case, the very purpose of depletion, which is to provide for a tax-free return of invested capital, was entirely ignored.

HOUSTON COLLIERIES CO.

The Houston Colliers Co. case (1945) was determined by the committee on appeals and review. This company was the lessee of coal lands under three mining leases, two of which were for 30 years and the third for 21 years. These leases were renewable at the expiration of their respective terms, at the same royalty, without bonus.

These leases were valued at $477,711.44. The committee on appeals and review held that the taxpayer should be permitted to deduct from his income one-thirtieth of the value of the 30-year leases and one-twenty-first of the value of the 21-year leases, regardless of mining operations.

The Supreme Court of the United States, in the case of the United States *v.* Biwabik Mining Co. (247 U. S. 116), held that a bonus paid for a mining lease is to be considered as a payment in advance of increased royalties. Certainly the value of a lease, due to low royalties, must be treated in the same manner as that same value if paid for by a bonus.

Royalties are payable in proportion to the coal mined and are deductible from income as paid. A bonus, or value in the nature of an increased royalty, should be deducted on the same basis.

It is obvious that the committee on appeals and review in deciding this case ignored the essential difference between a lease of property, which confers upon the lessee merely the right to use the property and leaves the property intact at the expiration of the lease, as in the case of the lease of lands for grazing purposes, or for agricultural purposes, or the use and occupancy of buildings, and a lease which confers the right to mine and sell coal or any other deposit and to occupy the property for that purpose.

In the first case, where the right to use only is leased, any value of the lease is exhausted by the mere lapse of time. In the case of a mining lease the value, if any, arises out of the excess of the value of the coal or other mineral in the mine over the royalty. In such case the value of the lease is not decreased by the lapse of time unless so much time is allowed to elapse without mining the ore that the value can not be recovered during the remaining period of the lease. This question is not involved here, because whatever value this lease had was attributable to the right to take and sell the coal. The real effect of this lease was a sale of so much of the coal in the ground as could be taken during the life of the lease, and the excess of the value of that right over the royalty paid is what was valued.

These leases were renewable at the end of their terms, but, under the ruling of the committee on appeals and review, the entire value of the leases could be deducted during the 30 and 21 year periods without mining a ton of coal. Thus the taxpayer could deduct this entire value of the leases, during the first period, from income from other sources and still have the full value allowed left in the lease. He could then renew these leases and sell the entire value, which he had already received as deductions. It is true that such value would then be taxable, but the whole purpose of the law is to determine the net income of each year, and for this purpose annual deductions for depletion have been provided for.

Amortizing the value of this lease on the basis of coal mined, the deductions for 1917 amount to $3,953.60, while the deduction allowed by the committee on appeals and review for 1917 amounted to $20,743.43 (1948).

The most serious effect of this determination was not the allowance of an excessive deduction to the taxpayer of nearly $17,000 from 1917 income. Mr. Davis, the chief of the coal valuation section, testified (1948) that this ruling is being urged as a precedent by other taxpayers who seek to amortize their leases upon the same basis, and that this ruling is very embarrassing to his section in maintaining the uniform method provided by the regulations. It is clear that if this ruling is not considered as a precedent, to be followed in other cases, there has been gross discrimination in favor of this taxpayer; and if it is considered as a precedent it substitutes an unsound and illegal method for the common practice which is economically sound.

Climax Fire Brick Co.

(1359)

The Climax Fire Brick Co. was permitted to amortize a lease to mine fire clay according to the same plan as that followed in the Houston Collieries case. This allowance was made by Mr. S. M. Greenidge, head of the engineering division, over the protest of Mr. Briggs, the chief of the nonmetals valuation section (1364).

BARGAINING WITH TAXPAYERS

It is believed that all of these unsound determinations were reached by bargaining with the taxpayers involved, for the purpose of effecting a settlement regardless of principle. The publication as precedents of all rulings in the Income Tax Unit which reverse the action of the engineering and audit sections would be effective in keeping the work of the Income Tax Unit in line with sound principles and would insure uniform application of principles, without which discrimination is the inevitable result.

DISCOVERY DEPLETION—DEPLETION OF DISCOVERY VALUE IS AN EXEMPTION

The provisions of the income tax law which permit discovery value to be depleted grant an exemption to those engaged in the mining and oil industry not granted to or enjoyed by other taxpayers.

The 1913 act and all subsequent income tax laws have treated all increment in the value of capital investments over cost which has accrued since March 1, 1913, as income which becomes taxable when realized by the sale of the property.

In Eisner *v.* Macombe (252 U. S. 189, 207) the Supreme Court of the United States defines income to be—

> the gain derived from capital, from labor, or from both combined, provided it is to be understood to include profit gained through a sale or conversion of capital assets.

The cost, or March 1, 1913, value of minerals or oil taken from the ground each year and sold in the regular course of operations is capital. To provide for the tax-free return of this capital the deductions, based upon cost, or March 1, 1913, value, are provided for. When the proper allowance for the return of the capital, represented by cost, or March 1, 1913, value, has been deducted from operating profits, all other gain derived from a mine or oil well is profit from operations or increment in value. In all other cases such profit is taxed.

The discovery provision permits the deduction, as depletion of the value of the property on the date of discovery or within 30 days thereafter. Thus the depletion deductions include not only the cost, or March 1, 1913, value, but all of the increment in value, due to the discovery of the existence of the mineral, oil, or gas. This increment in value is realized by the sale of mineral, oil, or gas in the process of operating the mine or well. This increment comes clearly within the definition of income by the Supreme Court, quoted above.

This increment in value, due to discovery, is the same increment which is realized if the oil well or mine is sold as a whole instead of by the ton or barrel, yet if the well or mine is sold as a whole, instead of by the ton or barrel, the taxable gain is the difference between the cost, or March 1, 1913, value, and the price obtained for the property. The Solicitor for the Bureau of Internal Revenue has so ruled. (Solicitor's Opinion 26, C. B., Dec. 1920, p. 44.) This ruling is undoubtedly sound, as the provision for discovery value is confined to depletion and no similar provision is contained in the provision of the act relating to the gain or loss on the sale of property.

The increment in the value of property due to the discovery of minerals, oil, or gas can in no way be differentiated, in principle, from the increment in the value of real estate, stocks, bonds, and other property, yet all such increment is taxed.

It may be said that the discoverer of oil or minerals assumes a great risk in drilling or prospecting in an unknown field. In the first place, attention is called to the fact that discovery depletion is allowed to the lessor, who sits idly by and risks nothing that is not risked by every investor in real estate. In the second place, we will show that the greater part of the allowances for discovery depletion are made to those who drill in proven ground, where the finding of oil is practically certain. Furthermore, every investor in speculative stocks, particularly those who invest in new enterprises, organized to manufacture new inventions, assume great risks of loss. *Except in the case of mines and oil and gas wells, no investor is permitted to set up the value of his business, after its success has been demonstrated, as a deduction from the profit to be derived from that business for the purpose of determining his net taxable income. Discovery depletion is not a deduction permitted for the purpose of arriving at the net income derived from mines and oil and gas wells. It is clearly an exemption from taxation on net income and as such is a discrimination against every other taxpayer and every other industry.*

DISCOVERY DEPLETION, $300,000,000 PER YEAR ON OIL

No statistics of the amount of discovery depletion allowed as deductions from taxable income have been compiled by the Bureau of Internal Revenue. Mr. Albert H. Fay, former chief of the natural resources division of the Income Tax Unit, estimates that the deductions allowed to oil producers alone for discovery depletion amount to approximately $300,000,000 per year. As practically all of this depletion is allowed to corporations, which are now taxed at the rate of 12½ per cent, the tax exemption enjoyed by taxpayers in this one industry is approximately $37,500,000 per year (1874). As these estimates were presented to the committee on February 10, 1925, and no exception has ever been taken to them by the bureau, we feel safe in assuming them to be fairly accurate.

It is obvious that during the high tax years this exemption was worth several hundred millions of dollars to the oil industry. This fact is shown by the allowances made to the Gulf Oil Corporation.

The Gulf Oil Corporation and subsidiaries were allowed depletion deductions, based on cost and 1913 values, for the three years 1917, 1918, and 1919, amounting to $11,517,427.42. These companies were allowed discovery-depletion deductions for 1918 and 1919 alone amounting to $20,996,496.33. Thus it appears that in this case the income exempted from tax, by reason of discovery depletion, in the two years 1918 and 1919 alone was nearly twice the capital depleted during the three years 1917, 1918, and 1919, and that the income exempted would have been taxed at a very much higher rate, had it been taxable, than the rate which was applied to taxable income. The discovery depletion allowed the Gulf Oil Corporation for 1918 and 1919 reduced its taxes for those years by $3,862,517.95.

Another illustration of the effect of discovery depletion is found in the case of the United Verde Extension Mining Co. (3406–3411). The 1913 value of the property of this company was determined to be $525,000, which was also the par value of the outstanding capital stock of the company. But for the discovery clause in the law, $525,000 would have been the amount this company would have been permitted to deduct from income as depletion during the life of its property.

In 1915 the company discovered an immensely rich deposit of ore As a result of the allowance of discovery value, the amount to be depleted was increased to $30,652,379. Thus during 1915 there was an increase in the value of the property of this company of $30,127,379, which will be realized in the form of operating profits during the life of the property, but which will be exempt from tax as discovery depletion.

In the Texas Gulf Sulphur Co. case a discovery value for depletion purposes of $38,920,000 was allowed on a property which had been purchased by the company for $250,000.

LIMITATIONS ON AMOUNT OF DISCOVERY DEPLETION DEDUCTIBLE

The provision for the depletion of discovery value was first inserted in the law in 1918. The 1918 act did not limit the discovery depletion allowable. It was found that in some instances the allowance exceeded the operating profit from the property, and the loss thus created was deducted from the income from other sources or carried forward as a deduction from the net taxable income of the succeeding year. To meet this situation the 1921 act provided that the discovery depletion allowable as a deduction shall not exceed the net income, computed without allowance for depletion, from the property on which discovery is made. The 1924 act further limited the discovery depletion allowable to 50 per cent of the net income, computed without allowance for depletion, "except where net income so computed is less than the depletion allowance based on cost or fair market value as of March 1, 1913."

DISCOVERY DEPLETION FOR RELIEF OF WILDCATTERS

(1865–66)

An examination of the hearings before the Ways and Means Committee of the House and before the Finance Committee of the Senate, when the 1918 act was under consideration by these committees, shows that the purpose of the provision for discovery depletion was to stimulate wildcatting or prospecting for the oil and minerals then needed to carry on the war.

The o. industry, through the representatives of its various associations of operators, represented to the committees of Congress that the country was then consuming oil in excess of production at the rate of 60,000 barrels a day.

The oil industry represented to Congress that the prospecting for new oil fields was mostly done by small individuals or concerns. When these prospectors or wildcatters struck oil they sold out and moved on to new undeveloped territory. Sometimes, for years, the wildcatter had no income from which to deduct his losses and expenses," and when he did find oil or mineral the tax rate was so high as to prevent him from even recouping the losses of former years. It was represented that relief from this situation was necessary to encourage that prospecting or wildcatting which was so essential to increase, or even maintain, the supply essential for the prosecution of the war (1865–66).

It was to meet this situation that the discovery provision was put into the 1918 act.

The situation intended to be met by the discovery provision has so changed that every reason advanced for its enactment has disappeared.

Except in the case of lessors, who spend nothing and risk nothing for the discovery of oil, practically all discovery depletion is allowed to corporations. The corporation tax has been reduced to 12½ per cent, and no reason is apparent why any corporation engaged in the operation of oil wells or mines should not pay a 12½ per cent tax on the profits it derives from the discovery of oil or mineral on its property.

An inventor may spend years of time developing an invention from which he may derive immense profits. During the time he is perfecting his invention the inventor, like the wildcatter, may spend much time and money and have no income from which he can deduct his expenses. The manufacturer of a new article may suffer losses over a long period pending the perfection of his manufacturing processes and the development of his market. Neither such inventor nor such manufacturer are permitted by the income tax law to capitalize the prospective profits to be derived from an invention or business developed since March 1, 1913, and deduct their present value from future net income for the purposes of taxation. There is, however, no difference in principle between the cases above stated and that of the prospector for oil or mineral.

Risk is an incident of profit in any business, and, as a rule, the greater the profit the greater the risk which is assumed. The fundamental principle of the whole income tax law is that net profit, "from whatever source derived," shall be taxed. The only exemptions from this rule are the discovery depletion allowed to oil well and mine operators and the income derived from tax-exempt securities.

The war emergency, arising out of the consumption of 60,000 barrels of oil per day in excess of production, which was pressed as a reason for the enactment of the discovery clause, has also passed. The production of oil now exceeds the demand. The present problem is how to conserve this natural resource.

Thus, neither the war necessity for an increased production, nor the high war tax, which it was claimed retarded production, can now be offered as justification for the continuance of this discriminating tax exemption.

LARGE OPERATING COMPANIES, NOT SMALL WILDCATTERS, BENEFICIARIES OF DISCOVERY EXEMPTION

Attention has already been called to the fact that the prospector who discovers new deposits of oil and mineral was represented to the committee of Congress as an itinerant adventurer, who, when he discovered an oil well or mine, sold out and moved on to new fields

(1865). Attention has also been called to the fact that discovery value is not an allowable deduction from the profits arising out of the sale of an oil well or mine, but is deductible only from the income arising out of the operation of a well or mine. It thus appears that the very class for whose relief this exemption was provided can not get the benefit of it, and the exemption can not accomplish its purpose of stimulating activity by this class.

That the wildcatter, who discovers new oil pools, has not been the real beneficiary of this exemption is shown by figures prepared by the oil and gas section of the Income Tax Unit and supplied to the committee (1869).

These figures show that out of 13,671 cases in which discovery depletion was claimed, only 35 were actual discoverers of new oil deposits. Of these 13,671 cases, discovery depletion had been allowed in 8,450 cases and 5,221 cases had not been reached for consideration by the oil and gas section.

Another examination of 200 cases made by the oil and gas section showed that 37.5 per cent of the amount of discovery value allowed for depletion was allowed on unproven ground, and 62.5 per cent to those who brought in wells in proven fields. These latter cases also showed that 36.3 per cent of the discovery values involved in them were allowed to small operators and 63.7 per cent was allowed to large operators. A note upon the table showing these figures, made by the engineer of the oil and gas section who made the investigation, states that "The very close uniformity in the percentages allowed small operators probably reflects consistent practice in the oil and gas section and also the unvarying operation of economic laws." He also states that the very close approximation of the percentage allowed wildcatters and those allowed small operators "probably indicates nothing more than that taking a large number of cases the original wildcatter is generally a small operator."

In considering the percentages shown for these 200 cases, it must be borne in mind that in classifying these cases a wildcatter is considered to be one who brings in a well outside of a 160-acre tract proven by a commercial well. An oil pool may be, and usually is, large enough to contain many times 160 acres. The real wildcatter, described before the Ways and Means Committee by the representatives of the oil industry, and for whose benefit this clause was enacted, is the discoverer of a new oil pool or field. The ratio in which he has benefited is indicated by the first figures above quoted, 35 out of 13,671.

Mr. Fay estimates that approximately \$10,000,000 out of the \$300,000,000, or 3⅓ per cent of the annual deductions for discovery depletion, has gone to wildcatters (1874).

LOSSES INTENDED TO BE RECOUPED BY DISCOVERY EXEMPTION ALSO DEDUCTED AS EXPENSE

One of the reasons most strongly urged for the enactment of the discovery clause was the fact that the prospector could not deduct the losses of years spent in prospecting, because during those years he had no income from which to deduct them.

The operating companies, who are practically the sole beneficiaries of this exemption, have income from which to deduct such losses, and the regulations promulgated by the commissioner permit them to make these deductions.

Article 223 of Regulations 45 and 62, article 225 of Regulations 65, applicable to the 1918, 1921, and 1924 acts, respectively, all contain the following provisions:

Such incidental expenses as are paid for wages, fuel, repairs, hauling, etc., in connection with the exploration of the property, drilling wells, building pipe lines, and the development of the property, may at the option of the taxpayer be deducted as a development expense or charged to capital account.

The cost of drilling nonproductive wells may, at the option of the operator, be deducted from gross income as a development expense or charged to capital account returnable through depletion and depreciation as in the case of productive wells (1881).

All losses of the Gulf Oil Corporation, due to drilling dry holes, have been charged to and deducted from income, as current operating expense (317).

Thus it appears that the large operators, who are the principal beneficiaries under this provision, can and do deduct their losses, due to the drilling of unproductive wells, from income either through expense deductions or the depletion of the cost of productive wells, and in addition deduct the value of productive discovery wells under a law adopted upon the theory that they could not otherwise deduct losses.

It is our recommendation that, if the discovery clause is not entirely repealed, the law should be so amended as to provide that discovery depletion should not be allowed to any taxpayer who has elected to either deplete as cost, or deduct as expense, the cost of drilling dry holes. Such a provision would place the operating company having income from which to deduct such losses on the same basis as the wildcatter, who has no income and for whose relief this clause was, for that reason, enacted.

KIND OF PROPERTY SUBJECT TO DISCOVERY DEPLETION

Section 214 (a) (b) provides for the depletion of "mines, oil and gas wells, other natural deposits, and timber," but the discovery clause of that section refers only to "mines, oil and gas wells." It is thus evident that Congress did not intend to extend the discovery clause to "other natural deposits and timber."

PENN SAND & GRAVEL CO.

(1399)

In the Penn Sand & Gravel Co. case the committee on appeals and review allowed discovery value to be depleted on a gravel pit.

Technically, any natural deposit may constitute a mine, and any extraction of inorganic matter from the soil or beneath the soil may constitute mining. If the word "mine," as used in the discovery clause, is to be construed to include such deposits as gravel, sand, clay, and stone, no force or effect whatever can be given to the words "other natural deposits," and by construction these words are read out of the act. It is a cardinal rule of statutory construction that force and effect must be given to every word in a statute, if it is possible so to do.

Gravel pits, sand pits, and quarries are not commonly referred to as mines, nor are those engaged in working such deposits commonly called miners. Giving the word "mine" the meaning ordinarily attributed to it, it does not include such deposits. It is evident that Congress, in enacting this statute, intended the word mine to be given its common and not its technical definition, and intended to exclude from the discovery clause such deposits of inorganic matter as are not ordinarily referred to as mines.

While the observance of the well-settled rules of statutory construction leave no doubt as to the meaning of this statute, in this respect, in view of the action of the committee on appeals and review in the Penn Sand & Gravel Co. case, it is recommended that, if the discovery clause is not repealed, it should be so amended as to leave no room for construction.

DISCOVERY DEPLETION NOT DEPENDENT UPON DISCOVERY OF DEPOSIT

The language used in framing the discovery clause has permitted an administrative construction, which is far beyond, and at wide variance from, its obvious purpose.

It is manifest from the hearings before the congressional committees, by whom this clause was considered, that its purpose was to stimulate prospecting for new deposits of oil, gas and minerals. Such purpose could not be accomplished by the allowance of tax-exempt discovery depletion upon deposits of mineral or oil known to exist prior to the occurrence of the event which is asserted as the basis of the "discovery."

The discovery clause provides for the allowance of depletion, based upon discovery value, "in the case of mines, oil and gas wells, discovered by the taxpayer after February 28, 1913." The commissioner has ruled that a "mine" or "well" means a developed mine or well, which can be operated at a profit, and that there is no discovery of a mine or an oil or gas well until it has been shown that it can be profitably operated.

Under this construction, taxpayers, who discovered no oil or mineral deposit, are allowed discovery depletion on the ground that they "discovered" that a previously known deposit could be profitably operated. The Penn Sand & Gravel Co. (1399), the Texas Gulf Sulphur Co. (3218, 3228, 3244), and the Carson Hill Gold Mines (Inc.), cases illustrate the effect of this construction of the act.

PENN SAND & GRAVEL CO.

In the Penn Sand & Gravel Co. case there was no dispute as to the facts. The organizer of this company, a paving and building contractor, observed a piece of real estate, which had been laid out in building lots, and upon which building operations had started. He secured three associates to cooperate with him in the purchase of this property for exploitation as a real-estate development. After securing an option on the property, he discovered that the material excavated in the digging of a well, then in progress, contained sand and gravel suitable for building purposes.

These four individuals then organized the Penn Sand & Gravel Co., which purchased the property, under the option above mentioned, for $54,954.36, and operated it as a gravel pit. The Penn Sand & Gravel Co. was allowed a discovery value of $150,297.07 on the ground that, although the gravel was known to exist prior to its purchase of the property, it was not until after the purchase that it was known to exist in sufficiently large quantities to permit the profitable operation of the property.

The existence of this gravel and its nature and extent, had been fully shown by the report of the second geological survey of Pennsylvania, published in 1881, and in a report of the United States Geological Survey, published in 1909. These facts were shown by a memorandum of Mr. Frank H. Madison, the valuation engineer, who handled this case for the Income Tax Unit, to Mr. J. H. Briggs, chief of the nonmetals section (1419). When Mr. Briggs forwarded this memorandum to Mr. S. M. Greenidge, head of the engineering division, he was severely reprimanded for disagreeing with his superiors (1420).

The effect of the allowance of discovery value, in this case, was to increase the amount to be deducted from income, for depletion, from 1.86 cents per ton to 3.29 cents per ton, and to convert a deficiency in tax of $10,613.15 into a rebate of $48,233.

TEXAS GULF SULPHUR CO.

The most striking case of the allowance of a discovery value on a previously known mineral deposit is that of the Texas Gulf Sulphur Co. (3217). This property had been purchased in 1909 for $250,000, and the discovery value allowed, as of 1919, was $38,920,000.

In considering this case, particular attention is called to the fact that, by the terms of the statute, discovery depletion is allowable only when the discovery is made subsequent to February 28, 1913.

As the Commissioner of Internal Revenue has submitted an answer to the criticism of this case by the committee's staff, the facts will be stated in detail.

This taxpayer was organized in 1909 under the name Gulf Sulphur Co., which name was changed in 1918 to Texas Gulf Sulphur Co. It acquired the property in question in 1909.

A report on this property, dated April 23, 1909, was made by W. J. M. Allen to the directors of the company (3244). This report is in the files of the Income Tax Unit, and was before the unit when the allowance of discovery value was under consideration.

This report shows that this property was extensively drilled for oil in 1903. Some oil was found, but, as an oil field, the property soon played out. Mr. Allen states that in 1903 from 10 to 12 feet of good sulphur was encountered in every well at depths varying from 900 to 1,000 feet. He quotes parties who were interested in oil wells as stating that in some instances they went through 60 feet of sulphur.

This Allen report shows that actual drilling for sulphur was in progress at the time of his examination of the property, in April, 1909, and he gives the log of a well then being drilled, and other wells drilled in 1908, as follows:

No. 1. Drilled by R. O. Middlebrook and Robert Stevens, Devers, Tex. (head driller), in August, 1908, for Matagorda Oil Co.; depth, 1,028 feet; found sulphur at 940 to 948 feet, and both Middlebrook and Stevens report the log as practically identical with No. 2; about 500 feet of 4-inch pipe pulled off and still in this hole.

No. 2. This is the well which was being drilled when I arrived; begun April 9, 1909; finished April 19, 1909. Days actual drilling, 20.

Cost (approximately), exclusive of pipe, use of rig, and freight, $700. Depth, 1,009 feet.

Log. Eighteen feet surface, 232 feet sand and shale, 185 feet gumbo and shale, 45 feet gumbo, 20 feet soft shale, 50 feet soft gumbo, 15 feet water sand, 35 feet gumbo, 4 feet rock, 6 feet gumbo, 90 feet slate, 3 feet rock, 25 feet hard shale, 102 feet gumbo, 6 feet hard rock, 109 feet gumbo, 8 feet rock and gypsum—953 feet; 16 feet medium soft sulphur, 3 feet gypsum and sulphur, 3 feet soft sulphur, 1½ feet gypsum, 2 feet soft sulphur, 1 foot hard rock, one-half foot rock, 14 feet soft rock sulphur, 8 feet medium, 7½ feet soft sulphur—56 feet; total, 1,009 feet.

Sample of gumbo, of which 200 feet overlays cap rock above sulphur, submitted herewith.

This stuff has the tenacity of rubber, and drillers say it will hold steam perfectly.

No. 3. Drilled by R. O. Middlebrook in October, 1908; struck cap rock at 1,140 feet; 4-inch drill, cap rock, 6 or 8 feet of sulphur; struck hard rock; lost water and quit. No. 3 is 240 feet northwest of the Lane well.

No. 4. Drilled by R. O. Middlebrook, November and December, 1908. Went down 906 feet; struck cap rock at 896 feet; set in 6-inch pipe on cap rock; left it and quit in the rock. Derrick still standing.

Lane well. Drilled by Sutherland & Lane in 1903; claim went down about 1,400 feet; claim went through 96 feet of sulphur at 1,140 feet; paid no attention to it.

This extensive quotation from the Allen report is given because in his answer the Commissioner of Internal Revenue states:

> The facts are that Mr. Allen was not a mining engineer; that at the time he made these claims he was financially interested in the properties and was attempting to secure financial support of his plans for development and that not a single hole or well had been drilled for the purpose of determining whether or not it contained sulphur and that there were no reliable data, samples, or logs in existence showing that the property contained sulphur.

It is evident that the commissioner did not examine the files of the unit before signing this answer, and has been misled by whoever prepared this answer for him. The above-quoted portions of the Allen report give the logs and data. Allen states in his report that he took samples.

The statement in the commissioner's answer that "not a single hole or well had been drilled for the purpose of determining whether or not it contained sulphur" is a mere evasion of the question.

There is nothing in the law which says that to constitute a discovery the discoverer must be looking for the particular thing he finds. What difference does it make whether a driller is looking for oil and finds sulphur or looking for water and finds oil or gold? The material fact is what he finds, not what he is looking for.

What difference does it make whether or not Allen was an engineer. There is nothing in the law which confines discoveries of oil or minerals to those made by engineers. The material fact is that he was present on the ground in 1909, while a well was being drilled in which sulphur was found, and gives complete data as to the sulphur found. He also interviewed men who in drilling for oil had discovered sulphur.

The commissioner lays great stress upon the fact that Allen was financially interested in the property in 1909 and was trying to secure financial support for its development as a sulphur property. Is the evidence of the existence of sulphur to be ignored because

Allen was financially interested? The allowance of this discovery value to this taxpayer meant an exemption of nearly $39,000,000 of income from taxation. Every item of evidence considered by the unit and now approved by the commissioner as the basis for the allowance was furnished by the taxpayer or by those employed by the taxpayer.

The fact is that nowhere in the record is there an iota of evidence even tending to contradict the facts stated in Allen's report.

Mr. Henry Krumit, geologist for the taxpayer, made a report in support of the taxpayer's claim for a discovery value (3251), in which he says:

In prospecting for oil in 1903 and 1904 some sulphur was noticed in the slush from the drilling. Sulphur had been found in other salt domes, and little attention was paid to it as oil and not sulphur was the object of the drilling. However, some St. Louis men hearing these reports of the finding of sulphur in various parts of Texas formed the Gulf Sulphur Co. in 1909 and began drilling at the Matagorda Big Hill dome to determine the extent of the sulphur deposit. In this early drilling the same methods were used as in drilling for oil. While some information was obtained as to the thickness of the sulphur deposit, practically nothing definite was learned as to the grade of the ore.

A statement by Mr. Spencer C. Browne, filed by the taxpayer in support of its claim for a discovery value (3258), contains the following:

During 1909–10 the Gulf Sulphur Co. drilled six holes, shown as holes A to F on company's maps. Holes A to E, inclusive, were sunk by inadequate methods and without competent supervision, and their records can not be considered of much value, except as an indication of the depth and thickness of the sulphur horizon. Hole F was more carefully drilled than the others, but proper methods were not used for recovery of the drill cuttings and representative samples were not obtained. Consequently the record of hole F, which suggested 13 per cent of sulphur in 59.5 feet of horizon, was not reliable. The thickness of the sulphur formation as found in this early drilling was reported as follows:

Hole	Thickness (feet)	Per cent sulphur
A	56.0	Undetermined.
B	85.6	Undetermined; said to be richer than A or C.
C	54.5	Undetermined.
D	35.0	Undetermined; very low grade.
E	41.0	Do.
F	59.5	About 13 per cent; not reliably sampled.

In July, 1910, while in the employ of clients now interested in the Texas Gulf Sulphur Co., I heard of the foregoing results of drilling and visited the Matagorda Big Hill and reported favorably regarding its prospects. Through a visit to St. Louis I became acquainted with Messrs. Einstein, Allen, and Harrison, and with the details of their exploration work at Big Hill; and while on this visit I persuaded Messrs. Einstein and Allen to come to New York to confer with my clients. As a result of these conferences, and in the light of further information regarding sulphur that we developed during our exploration of the Bryan Heights deposit in 1910 and 1911, my clients gradually acquired the controlling interest in the Gulf Sulphur Co. during the next few years.

Thus the statement of the commissioner that "not a single hole or well had been drilled in the property for the purpose of determining whether or not it contained sulphur" is squarely contradicted and disproven by this report, filed by the taxpayer itself in support of its claim.

This taxpayer conceded that the discovery of the existence of sulphur occurred in 1903; and that it had been demonstrated in 1909 that the deposit was a large one.

Is it reasonable to assume that this company would have paid $250,000 for this property and would have invested $5,000,000 in a plant for the extraction of sulphur, if it was not satisfied that the sulphur was there and could be recovered at a profit? If the evidence was sufficiently convincing to move the taxpayer to make this enormous investment, why should it not have satisfied the commissioner?

This claim for discovery value was based and allowed on the sole ground that it was not until a $5,000,000 plant had been built and went into operation in 1919, that the fact was established that this deposit could be profitably operated.

The method of extracting this sulphur from the ground was not a new one. Superheated water is pumped into the deposit which melts the sulphur. The molten sulphur then runs into wells, from which it is forced to the surface by compressed air. This method had been in successful operation since 1896 in sulphur mines in the same locality, where the sulphur and geological conditions were the same as in the mines of this taxpayer.

Thus it appears that although the existence of this large body of sulphur had been known since 1909, and the method of extraction had been known since 1896, the Commissioner of Internal Revenue has, by his answer in this case, approved a ruling that there was no discovery within the meaning of this act until after 1913, and discovery depletion is, therefore, allowable.

As thus construed, the discovery of a mine does not mean the discovery of the deposit, nor even the discovery of the deposit plus a method of extraction, but the discovery that the enterprise will produce a profit, when the method is applied to the deposit.

This construction of the discovery clause extends the tax exemption afforded by it to an almost unlimited extent. Thus interpreted, a discovery exemption can be allowed wherever known ore bodies which could not be profitably worked became profitable by the application of new methods. In such cases the real discovery is made by the inventor of the process, yet any profit he derives is fully taxed.

A may find a deposit of low-grade ore which can not produce a profit without the utilization of a process invented by B. A has not sufficient capital to install the equipment necessary to utilize B's process and therefore can not operate his property at a profit. Under the construction given the discovery clause, there has been no "discovery." A sells this deposit to C, who utilizes the process invented by B, and operates the property at a profit. C is now permitted to capitalize the expected profit, to be derived from the deposit found by A, and which becomes valuable because of B's invention, and is permitted to set up the present value of such profits as tax exempt depletion.

Assume that A derives some profit from the sale to C, because of the known existence of the undeveloped ore body. Assume also that B, through royalties, or profit on the sale of equipment, derives some profit from the use of his process by C. While A and

B have made the only real discoveries involved, A by finding the ore body and B by inventing the process, they must both pay a tax on the full profit they derive from such discoveries, yet C, who merely utilizes the discoveries of A and B, is given the discovery exemption.

This hypothetical case illustrates exactly what happened in the Texas Gulf Sulphur Co. The company paid $250,000 for this property in 1909 because the existence of sulphur had been demonstrated by drilling for oil. Had this sulphur been found and this land sold subsequent to 1913, the vendors would have been subject to tax upon the increment in values due to the known presence of sulphur. The process was invented long before and patented. Had the inventor received a royalty for its use, he would have been subject to tax upon that royalty. Yet the Texas Gulf Sulphur Co., which utilized the fact that sulphur was found by one and a process invented by another, is permitted to deduct nearly $39,000,000 from the profits they derive from the property as tax exempt.

Oil furnishes an excellent illustration of what may be done under this construction of the discovery clause. The Alpine Oil Co. brought in the first well in the extension of the Eldorado pool in Kansas (2098–2099). As their operations showed a loss, they made no claim for and were allowed no discovery value. After the existence of oil in this pool had been demonstrated by the Alpine well, the Gypsy Oil Co. developed a 40-acre tract in this same pool, upon which they are claiming a discovery exemption of $8,000,000 (1999–2019).

It is an established fact that the methods now in use in this country only recover from 10 to 15 per cent of the oil, and that the remaining 85 to 90 per cent is retained in the sands. In Europe such sands are being mined to recover the oil which can not be recovered by pumping.

When the time comes that it will be profitable to mine our oil-bearing sands, the discovery clause, as now construed, will permit the allowance of discovery values on them, although their location, extent, and the quantity and quality of oil they bear is being absolutely demonstrated by our present operations.

Under the precedent established by the sulphur and gravel cases cited, the fact that the existence of the oil is known does not constitute a discovery. Under these precedents a discovery will not take place until plants have been erected and mining operations commence. If the business is then profitable a discovery value can be claimed and allowed as tax exempt.

This construction defeats the very purpose of the law, which was to stimulate prospecting.

The taxpayer who discovers a profit in the development of a known ore body or in a known pool of oil can not be differentiated in principle from the taxpayer who discovers a profit in manufacturing.

30-DAY LIMIT ON DISCOVERY VALUE IGNORED

The discovery clause provides that the discovery "depletion allowance shall be based upon the fair market value of the property at the date of discovery, or within 30 days thereafter."

The prospector who discovers a mineral can not usually develop the quality nor the extent of the ore body within 30 days, and 30 days will not develop the full value which may be derived from an oil pool or field. The mere discovery of ore or oil will, however, enhance the value of the property upon which it is found. The subsequent development of the mine or oil tract may enhance the value of the property to many thousand times what anyone would pay for the mere prospect existing on the date of discovery or within 30 days thereafter.

This 30-day limitation verifies the only inference which can be drawn from the hearings held in 1918, that the purpose of this provision was to relieve the prospector, and that it was not intended to create a tax exemption in favor of those who might subsequently develop the property. It is also clear that it was the intent of Congress to limit the exemption to that first increment in value which can be based upon the highly speculative conditions existing within 30 days after discovery, and that the greater value shown by subsequently developing the property was not to be exempted through discovery depletion.

It is, however, the practice of the Income Tax Unit to permit the full development of the property before the 30 days begin to run. Thus, for all practical purposes the 30-day limitation is read out of the law. The course of reasoning followed is that there is no discovery until the amount of profit to be realized can be shown, and that this can not be shown until the property is developed.

UNITED VERDE EXTENSION MINING CO.

(3411)

In the case of the United Verde Extension Mining Co. the deposit was discovered in 1915, but its extent was not developed until December 31, 1916. December 31, 1916, was the date accepted as the date of discovery. This company was therefore allowed over a year, instead of 30 days, within which to develop value for discovery-depletion purposes. While we have no way of knowing what the value would have been, had it been confined to that value demonstrable within 30 days after the deposit was discovered, it is safe to assume that it would have been but a small fraction of the $30,652,379 allowed as the value on December 31, 1916, over a year after the discovery of the deposit.

TEXAS GULF SULPHUR CO.

(3217)

In the Texas Gulf Sulphur case, while the deposit was known to exist in 1903, when the property was purchased for $250,000, and was known to be 56 feet thick in 1909, drilling operations were carried on during 1917 and 1918 to develop its full extent and quality. The property is valued, as of March, 1919, at over $38,000,000. The value allowed for depletion is the value after full development and includes the increment due to development.

CARSON HILL GOLD MINES (INC.)

(See supplement)

The Carson Hill Gold Mines (Inc.) case shows how the application of this principle by the Income Tax Unit removes every limitation placed by Congress on discovery depletion.

This mine was discovered long before March 1, 1913, and was being operated on March 1, 1913. Subsequent to March 1, 1913, the operation of the mine was abandoned because the ores were of such low grade as to be unprofitable to mine.

During 1916 W. J. Loring, who was working an adjoining property containing very rich ore, and who believed that the rich ore extended into the property of the old mine, secured an option to purchase the mine for $600,000 cash, or 40 per cent of the stock of a company organized to acquire the mine. By the terms of the option Loring was permitted to explore the property, and the proceeds of any ore mined during the option period were to be placed in escrow to be applied on the purchase price in case the option was exercised.

On September 25, 1917, high-grade ore was discovered, but the extent of it was not fully developed.

On November 27, 1917, the taxpayer was incorporated, and on the same day acquired the option from Loring.

The work of developing the extent of the rich ore body continued from September 25, 1917, to November 30, 1918, when the taxpayer notified the owners that it exercised the option.

On December 28, 1918, the taxpayer acquired title to the property for $600,000.

The solicitor, in an unpublished ruling, held that the taxpayer was entitled to discovery depletion based on a valuation as of the date it acquired the property, December 28, 1918.

Based upon the proven and probable ores shown on December 28, 1918, a discovery value of $1,316,363.82 was allowed, all of which was deducted from the income of 1919 to 1922, inclusive.

EXCEPTIONS TO ALLOWANCE

The law provides that depletion based on discovery value shall be confined to "mines discovered" by the taxpayer since February 28, 1913, where not acquired as the result of the purchase of a proven tract or lease, and that the basis of such depletion shall be the fair market value as of date of discovery or within 30 days thereafter The law further provides that discovery depletion shall only be allowed when the value after discovery is materially disproportionate with cost.

The allowance in this case is barred by every condition stipulated in the statute. Unless there is to be discrimination, the solicitor's opinion in this case should constitute a precedent.

First. This mine was not discovered since February 28, 1913. This was a mine which was in actual operation on March 1, 1913, and upon which a March 1, 1913, value had been placed for depletion purposes. It is true that a deposit of high-grade ore had been overlooked, but there is no way to tell as of March 1, 1913, what grade of ore may be encountered in subsequent operation. The law provides that the depletion of mines discovered prior to March 1, 1913, shall be based on cost or March 1, 1913, value.

Congress can not be said to have intended that the mere discovery in an old mine of a higher grade of ore than was evident in 1913 should create a newly discovered mine. To be consistent, an overestimate of the quantity and grade of the ore, as shown by subsequent operations, would warrant reducing the 1913 value. Upon this theory no 1913 value could stand unless subsequent operations verify every estimated factor. Congress must be credited with knowing that there is no way to tell as of March 1, 1913, what grade of ore may be subsequently encountered; and 1913 value within the meaning of the act must be construed to be such values as was evident from 1913 conditions.

Second. Assuming for the purpose of discussion that the discovery of this rich deposit created a new mine, this new mine was not discovered by the taxpayer.

The rich deposit upon which this discovery value was based was discovered on September 25, 1917, and the taxpayer was not organized until November 27, 1917. It certainly can not be said that a corporation before organization is any more capable of discovering a mine than is an unborn child.

Third. This mine was acquired as the result of the purchase of a proven tract or lease.

The date accepted by the Income Tax Unit in making this allowance as the date of discovery is November 30, 1918, the very day upon which the taxpayer exercised the option to purchase. This is 14 months after the rich ore was first discovered, during which time operations to develop the extent of the ore had then been in progress. It was not claimed that anything happened on this particular date which made known anything not known the day before. This date was obviously accepted as the discovery date, because to have fixed the discovery date one day earlier would have denied discovery depletion.

The solicitor holds that the taxpayer did acquire a proven tract, but yet holds it entitled to discovery depletion, upon the ground that the option gave it possession and the right to mine during the option period. The right of an option holder who has a license to mine during the option period to depletion is not involved in this case. The discovery depletion is granted in this case to the purchaser of this fee for depletion to be sustained after the purchase of the fee. The word "purchase" when a fee is involved can mean nothing except an executed contract of sale. The rights of the taxpayer prior to the sale on November 30, 1913, were such as arise out of an executory contract to purchase. Whatever its rights to depletion may have been under its option prior to the purchase of the fee, it did not purchase the fee upon which depletion was allowed until the exercise of the option terminated its rights as an option holder. When the sale was made on December 28, 1918, a purchase was effected and, as the solicitor properly holds, a proven tract was purchased.

But even conceding that the acquisition of the option by the taxpayer on November 27, 1917, constituted a purchase within the meaning of the statute does not entitle it to discovery depletion. The discovery was made on September 25, 1917, and the option was not acquired by the taxpayer until two months after the discovery.

Therefore, unless this statute is to be construed to mean that a "discovery" for depletion purposes is deferred after the existence of the ore has been discovered for an indefinite time within which the taxpayer can develop the full value of the mine, this taxpayer was not entitled to discovery depletion, because in acquiring the option it purchased a proven tract or an interest in the lease.

Fourth. The fair market value of the property after discovery was not materially disproportionate to the cost, and therefore discovery depletion is not allowable. The original option holder owned the adjoining property upon which the existence of a rich ore body had been developed. He expected to find that his known ore body extended into the property covered by the option. He did not buy, taking the chance of finding rich ore. He took an option to buy, in case he found the rich ore, and the price fixed in the option depended upon finding this ore. The option price was, therefore, the price to be paid by a willing buyer to a willing seller of the property after the existence of the ore had been determined. The option price was a discovery value, based entirely upon discovery, and was the exact cost. The fact that the unit's appraisal is disproportionate to the cost merely shows the extent to which the discovery value was increased by the development of the property after discovery and before December 28, 1918.

Fifth. The allowance of a period of 14 months after the discovery of the existence of the high-grade ore violates the provision of the statute that the value depleted shall be as of the date of discovery or within 30 days thereafter. The very purpose of this limitation was to restrict the value to be depleted to the increment due to discovery and to prevent the inclusion in the value to be depleted of values developed by developing and blocking out the ores.

Allowing values developed after 30 days has the effect of reading the 30-day limit out of the statute, because if 14 months can be allowed after the discovery of the ore body 14 years can be allowed.

DUPLICATE DISCOVERIES OF THE SAME MINE

Subdivision of section 211 provides:

In the case of the bona fide sale of mines, oil or gas well, or any interest therein, when the principal value of the property has been demonstrated by prospecting or exploration and discovery work done by the taxpayer, the portion of the tax imposed by this section attributable to such sale shall not exceed 16 per cent of the selling price of such property or interest.

Loring held the option on the Carson Hill property prior to the organization of the Carson Hill Co. and at the time rich deposit was found, and he did the exploration work. Assume that he had sold his option to the Carson Hill Co. at a profit, such profit would be clearly attributable to the discovery of the rich ore found by him and he would be clearly entitled to the benefit of the above-quoted provision of section 211. Under the theory upon which the allowance was made to the Carson Hill Co., it would also be entitled to discovery depletion, not because it discovered the deposit but because it developed the extent of it. Thus we would have two different discoveries of the same ore deposit at two different dates and the allowance of discovery benefits to two different taxpayers.

It was established before the committee that in some cases the valuation of oil wells for discovery-depletion purposes by the oil and gas section of the Income Tax Unit were based upon several years actual production. Evidence of this practice was presented in respect to the valuation of the property of the Gypsy Oil Co. (2003), the California Petroleum Co. (2999), and the Margay Oil Co. (2973). In one case the unit 18 months after the discovery refused to make a valuation upon the ground that production over a sufficient period was not known (2967).

It is obvious that the purchaser of an oil well on the date of discovery or within 30 days thereafter would have no means of knowing the subsequent actual production. He would buy an unknown quantity of a highly speculative nature and would fix his price accordingly.

Under the head of "Analytical appraisals" we discuss the methods and factors used in making valuations for the purpose of determining discovery value. We show how this basing of value on known production has been used by the Income Tax Unit as a justification for the use of wholly inadequate discount factors in reducing prospective profits to present value as of date of discovery. It is clear that any purchaser of an oil well on the date of discovery or within 30 days thereafter who could not know what the well would produce would expect a high rate of profit to compensate him for his speculative hazard, and would pay less for the well than if he knew what the actual production would be.

SUMMARY ON DISCOVERY OF PROFIT

By importing the element of profit into the discovery clause and by fixing the date of discovery at the date when the amount of profit to be expected has been developed, instead of at the date when the existence of the deposit is discovered, the date of discovery for depletion purposes is postponed, with the following results:

The discovery exemption (confined by law to the taxpayer who makes discovery) is allowed to taxpayers who did not discover a deposit but who merely developed property after the deposit had been discovered by a predecessor in title. This is illustrated by the Penn Sand & Gravel case (1399) and Carson Hill case.

The discovery exemption (confined by the law to discoveries since March 1, 1913), is allowed upon deposits discovered prior to March 1, 1913, but not fully developed and operated until after March 1, 1913. (The Texas Gulf Sulphur Co. case.) (3217.)

The discovery exemption (confined by the law to the value as of date of discovery or within 30 days thereafter) is measured by the increment in value due to the full development of the property, instead of merely the increment in value due to the discovery of the deposit. (See United Verde Extension Mining Co., 3411, Texas Gulf Sulphur Co., 3217, and oil cases.)

INCONSISTENT RULING ON DISCOVERY OF COAL

On page 357 of the hearings, Mr. S. M. Greenidge, head of the engineering division of the Income Tax Unit, testified as follows:

"Pardon me, but discovery is not allowable, and has never been allowable in coal, because the coal fields have been treated as being known by our geological bulletins or by other publications, such as the Bureau of Mines, so that the discovery factor does not apply to coal.

How this determination that discovery exemption is not allowable on coal, because the coal fields are shown by geological publications, can be reconciled with the allowances made in the Penn Sand and Gravel and the Texas Gulf Sulphur and to oil wells brought in after a pool has been discovered does not appear.

In the Penn Sand and Gravel case the gravel was not only shown by the official publications of both the United States and the State of Pennsylvania, but had been actually found on the property in the material excavated in digging a well prior to the acquisition of the property by the taxpayer.

In the Texas Gulf Sulphur Co. case the existence of the sulphur had been shown by drilling for oil in 1903, and the fact established by drilling in 1907 that the sulphur deposit was 56 feet thick. Thus the fact that the deposit was there was known prior to March 1, 1913.

As has been pointed out, these allowances were made upon the theory that discovery was not made until the fact was established that the operation of these properties would return a profit. Many coal mines have been closed down because they did not yield a profit. The same statutes and the same regulations apply to coal which apply to sulphur.

Why the actual knowledge of the existence of sulphur or gravel is not sufficient to prevent the discovery, if discovery depletion is denied upon coal, because its existence is shown by geological publications, is difficult to explain.

It is also difficult to explain how a taxpayer, who drills an offset well within a few feet of a producing well, or who drills a well between producing wells in a developed pool of oil, can be said to "discover" oil, when discovery is denied to coal because its existence is shown by geological publications.

It is therefore recommended that if discovery depletion is not entirely eliminated the law be so amended as to confine it to the discovery of a deposit.

REGULATIONS DEFINING PROVEN AREA AND DISCOVERY

The first interpretation placed upon the discovery provision by the Commissioner of Internal Revenue confined the discovery exemption to the discoverer of a new oil pool.

The 1919 edition of Regulations 45 contained the following provisions:

ART. 220. *Discovery of oil and gas wells.*—In order to take advantage of his discovery on and after March 1, 1913, of oil or gas wells, the taxpayer must show (*a*) that the tract for which such valuation is claimed was not proven oil land as to the particular sand or some discovery of which is claimed at the time the so-called discovery was made, proven oil land being that which has been shown by finished wells, supplemented by geologic data.

to be such that other wells drilled thereon are practically certain to be commercial producers; (b) that the discovery was a bona fide discovery of a commercial well of oil or gas, or both of these substances, on the property in question, a commercial well being one whose production is such as to offer a reasonable expectation of at least returning the capital invested in such well through the sale of the oil or gas, or both, derived therefrom during its economic life; and (c) that the fair market value of the property was materially in excess of the cost.

The 1919 edition of the "Manual for the oil and gas industry," issued by the Commissioner of Internal Revenue as an official publication for the guidance of taxpayers in the oil and gas industry, at pages 40 and 41, contains the following:

COMMISSIONER'S RULING

The clause from sections 214 (a) and 234 (a) of the tax law referred to above was inserted to protect the prospector or "wildcatter" who goes into an unknown field and, overcoming hazards of the business, discovers a new and valuable deposit of oil or gas, and by so doing increases the value of his holdings to such an extent that their value at the time of the discovery, or within 30 days thereafter, is materially disproportionate to their cost. The discovery may refer to the opening up of a new pool or field, or it may refer to the tapping of a new and previously unknown sand or zone in an old pool or field. The benefits, however, will accrue solely to the holdings of the taxpayer actually making the discovery. And it will affect him only in so far as he is able to prove that his discovery was bona fide, and that it has so increased the value of his holdings as to make it materially disproportionate to the cost.

Unless the taxpayer proves to the satisfaction of the commissioner that his so-called discovery well has opened up an entirely new pool or structure, or a new sand or zone in the particular pool or structure in which the operation takes place, this law will not apply to (a) any tract or lease any part of which was proven or producing prior to the date of (the alleged) discovery; (b) nor to any tract or lease within the proven limits of any well-recognized oil or gas pool or field; (c) nor to such wells as are drilled immediately in advance of producing wells; (d) or on the edge of proven territory. Neither will it apply to the tract or lease of any other than the taxpayer making the bona fide discovery.

In the 1920 edition of Regulations 45 we find article 220 amended and reading as follows:

ART. 220(a). *Discovery—Proven tract or lease—Property disproportionate value.*—(1) For the purpose of these sections of the revenue act of 1918 an oil or gas well may be said to be discovered when there is either a natural exposure of oil or gas or a drilling that discloses the actual and physical presence of oil or gas in quantities sufficient to justify commercial exploitation are deemed to exist when the quantity and quality of the oil or gas so recovered from the well are such as to afford a reasonable expectation of at least returning the capital invested in such well through the sale of the oil or gas, or both, to be derived therefrom.

(2) A proven tract or lease may be a part of the whole of a proven area. A proven area for the purposes of this statute shall be presumed to be that portion of the productive sand or zone or reservoir included in a square surface area of 160 acres having as its center the mouth of a well producing oil or gas in commercial quantities. In other words, a producing well shall be presumed to prove that portion of a given sand, zone, or reservoir which is included in an area of 160 acres of land, regardless of private boundaries. The center of such square area shall be the mouth of the well, and its sides shall be parallel to the section lines established by the United States system of public land surveys in the district in which it is located. Where a district is not covered by the United States land surveys the sides of said area shall run north and south, east and west.

So much of a taxpayer's tract or lease which lies within an area proven either by himself or by another is "a proven tract or lease" as contemplated by the statute, and the discovery of a well thereon will not entitle such taxpayer to revalue such well for the purposes of depletion allowances unless the tract or lease had been acquired before it became proven. And even though a well is brought in on a tract or lease not included in a proven area as heretofore defined, nevertheless it may not entitle the owner of the tract or lease in which such well is located to revaluation for depletion purposes, if such tract or lease lies within a compact area which is immediately surrounded by proven land, and the geologic structural conditions on or under the land so inclosed may reasonably warrant the belief that the oil or gas of the proven areas extends thereunder. Under such circumstances the entire area is to be regarded as proven land.

(3) The "property" which may be valued after discovery is the "well." For the purposes of these sections the "well" is the drill hole, the surface necessary for the drilling and operation of the well, the oil or gas content of the particular sand, zone, or reservoir (limestone, breccia, crevice, etc.) in which the discovery was made by the drilling, and from which the production is drawn, to the limit of the taxpayer's private bounding lines, but not beyond the limits of the proven area as heretofore provided.

(4) A taxpayer to be entitled to revalue his property after March 1, 1913, for the purpose of depletion allowances must make a discovery after said date, and such discovery must result in the fair market value of the property becoming disproportionate to the cost. The fair market value of the property will be deemed to have become disproportionate to the cost when the output of such well of oil or gas affords a reasonable expectation of returning to the taxpayer an amount materially in excess of the cost of the land or lease if acquired since March 1, 1913, or its fair market value on March 1, 1913, if acquired prior thereto, plus the cost of exploration and development work to the time the well was brought in.

There has been no change in article 220 in the regulations promulgated under the 1921 and 1924 acts, except to change the article number to 222 in Regulations 65, promulgated under the 1924 law.

All allowances for discovery exemption have been made under the regulations in force since 1920.

The definition of a "proven area" as "that portion of the productive sand or zone or reservoir, included in a square surface area of 160 acres, having as its center the mouth of a well producing oil and/or gas in commercial quantities," so limits a "proven" area as to permit many such proven areas upon any one pool of oil.

This definition of a "proven" area was repeatedly criticized during the hearings as being purely arbitrary and having no relationship whatever to the size or shape of the geological structures, in which oil is usually found (1880). The representatives of the Bureau of Internal Revenue have, however, made no attempt to justify this arbitrary limit. The first regulations fixed no hard and fast limits. As oil pools vary in size, no hard and fast limits can be fixed. The first regulations, like the California State Mining Bureau (1880) and the Federal leasing act, recognize a proven area as that area included within a geological structure in which oil has been found by bringing in of a commercial well.

Mr. Gregg, for a first time, made some contention that the regulations provided for the consideration of geologic indications. Mr. Greenidge, head of the engineering division of the Income Tax Unit, who has sole jurisdiction over the administration of the discovery provision of the law, disposed of Mr. Gregg's contention by admitting that the 160 acre rule was always followed (1920).

This arbitrary limitation of a proven area to a square area of 160 acres has permitted the blanketing of oil pools by the innumerable "discoveries," which will be later described, and the allowance of a greater part of the discovery exemptions to oil companies on wells drilled upon areas actually proven by geological indications supplemented by producing wells.

As will be shown, this definition of a "proven" area permits the allowance of discovery exemption on offset wells and upon wells lying between, but not entirely surrounded by producing wells on the same geologic structure.

DISCOVERY EXEMPTION ALLOWED ON PREVIOUSLY PROVEN AREA

Attention is next called to the fact that the regulations permit, and it is the uniform practice of the Income Tax Unit to allow discovery exemption upon areas which have been previously proven by the well of another owner or lessee, provided such areas were not proven at the date of acquisition of the property.

Thus A, the lessee of the north half of a quarter section of land, brings in a well 10 feet north of the center of his south boundary. This well will prove all of the south half of the section except a strip 10 feet wide along the south boundary of the south half. If B had a lease on the south half of the section prior to the bringing in of A's well, and drills an offset well but a few feet south of A's well, B will be allowed discovery exemption on his entire 80 acres, notwithstanding the fact that A's well proved all of his land except the south 10 feet.

An illustration of the operation of this provision of the law and regulations is afforded by the Gypsy Oil Co. case (2003). This company acquired a lease on a 40-acre tract prior to the bringing in of a well on an adjoining tract by the Carter Oil Co. The Carter well proved the area upon which the Gypsy well was located and about 400 feet beyond it, yet the Gypsy company sets up an $8,000,000 discovery value, which is clearly allowable under the law and regulations. This case is typical of two-thirds of the allowances made for discovery depletion.

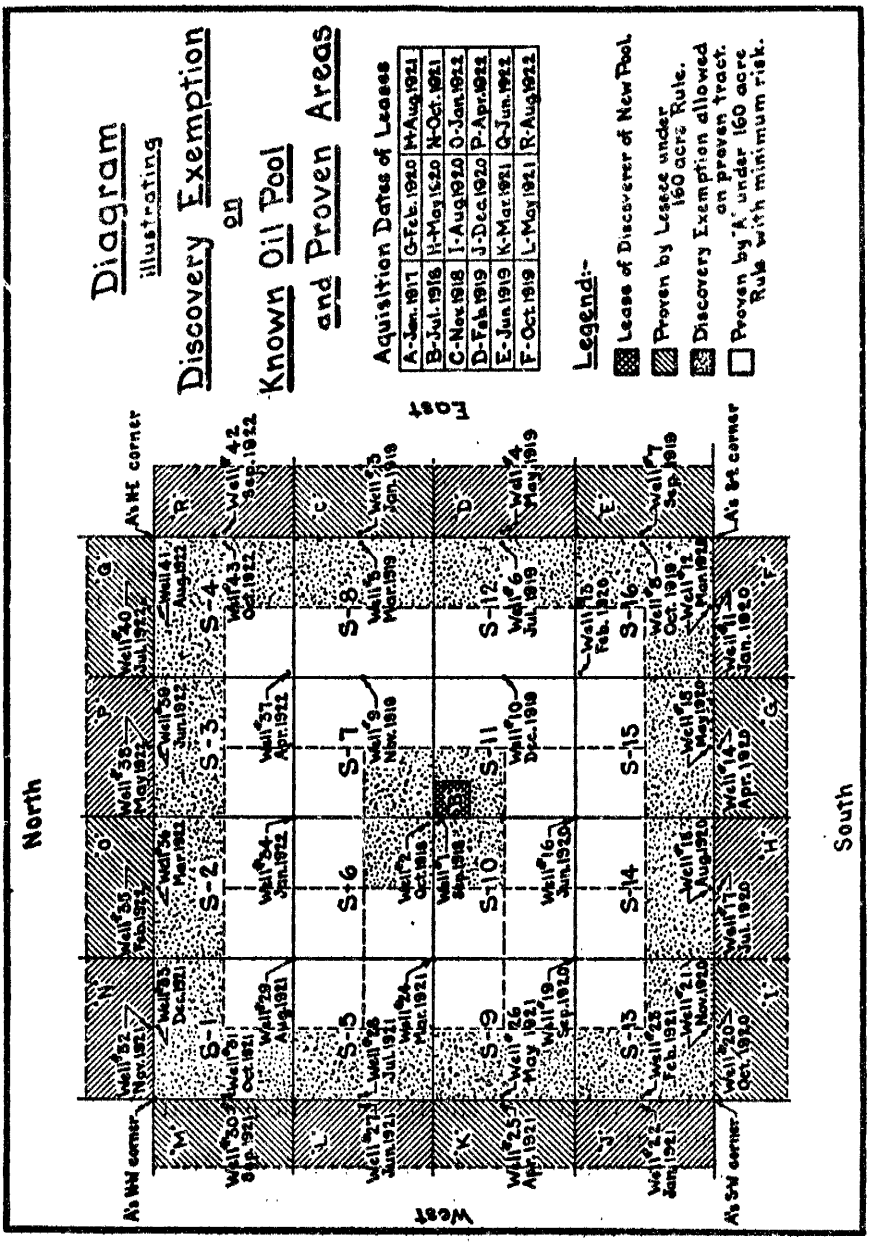
AREA VALUED FOR DISCOVERY EXEMPTION

In determining the value to be allowed upon a discovery well, the value of all of the oil estimated to lie within that portion of the 160 acres of which the well is the center which is owned or held under lease by the taxpayer is included (2006). Thus, if a taxpayer has a lease on 160 acres, and the discovery well is in the center of the tract, the amount of oil estimated to be underlying the entire tract will be valued. If, however, the discovery well is in the center of the north boundary, only the oil in the north 80 acres will be valued. A well on the corner of a 160-acre tract owned or leased by the taxpayer will be valued on the basis of the estimated recoverable reserves from 40 acres.

The diagram on page 38 illustrates hypothetically how discovery exemption is allowed on known oil pools and on proven areas by the bureau, according to their interpretation of the law as stated in the regulations.

We assume in this hypothetical case that the geological conditions indicate that a certain area, several square miles in extent, contains oil. The A Oil Co. procures leases on four sections (16 quarter sections) of this area. These 16 sections are shown on the diagram, numbered S1 to S16, inclusive. Each of these quarter sections contains 160 acres, and the total area leased by the A Oil Co. is therefore 2,560 acres. The lease provides that drilling operations must be begun within two years from the date of lease.

When the two years are about up B, a wildcatter, procures a lease from the A Oil Co. of 10 acres, which is practically in the center of the A company's lease. As no wells have as yet been



brought in from this geological structure, the A company is willing to lease this 10 acres to B on reasonable terms, rather than risk their own money in drilling on the strength of geological indications alone. On the diagram B's 10 acres is the shaded area in the northwest corner of quarter section S–11.

B drills a well in the northwest corner of his 10 acres, as near as possible to the corner, that he may draw as much oil as possible from beyond his property line in case he strikes oil. B brings in a commercial well and is allowed a discovery value based upon the estimated amount of oil under his 10 acres. This well is shown on the diagram and is marked "Well No. 1." Under the regulations this oil well proves 160 acres, as shown by the dotted line on the diagram, Well No. 1 being in the center of the area inclosed by this line. This well then proves approximately 40 acres of each of the quarter sections S–6, S–7, S–10, and S–11.

The A Oil Co. now drills offset wells as near A's well as possible to prevent B from taking their oil, the presence of which has been shown by B's well No. 1.

The first well brought in by A Co. is indicated on the diagram as well No. 2. Although well No. 2, being in practically the same position as well No. 1, can not be said to prove again this same 160-acre tract shown by the dotted line, nevertheless a discovery valuation is set up, based on this well No. 2 as a discovery well, which includes an estimate of all the oil under 150 acres (that is, the 160-acre area shown minus the 10-acre tract leased by B, which is, of course, excluded). A Co. therefore in spite of the fact that practically all of this 160-acre tract was proven by B's well No. 1, gets a full discovery exemption for all of the 150 acres left, because the company had acquired the lease before B discovered oil.

The C Oil Co. now acquires a lease on the land east of quarter section S–8, which is, as before stated, under lease by the A Oil Co. C Co. drills and brings in well No. 3, as shown on the diagram. The 160 acres proven by this well No. 3 is shown by dotted lines on the east and west, and on the north and south the quarter-section lines denote the limits of the proven area. The discovery exemption is allowed C Co. for the oil under approximately 80 acres of this tract as shown by the shaded area between the two quarter-section lines adjacent to well No. 3.

In the same way the D Oil Co. leases a tract east of quarter-section S–12 and immediately south of C Co.'s lease. D Co. brings in well No. 4 and this proves another 160 acres, indicated by the dotted lines. The discovery exemption to D Co. is based on the oil under the 80 acres as shaded on the diagram.

While both well No. 3 (C. Co.'s) and well No. 4 (D Co.'s) were in the same pool discovered by B, and their leases were not acquired until after the wells of A and B had been brought in, both C and D Cos. get the discovery exemption on 80 acres, because their wells were outside the 160-acre proven area limit set up by the regulations, the position of which is determined by the location of wells No. 1 and 2.

A Co. now drills offset wells Nos. 5 and 6, as shown on the diagram, as near as possible to wells No. 3 and 4, brought in by the C and D Co., in order to protect his oil. As wells No. 5 and 6 are very close to Nos. 3 and 4, it is evident that the 160-acre tract of which they are the center is practically the same 160-acre tract already proven by wells Nos. 3 and 4.

Notwithstanding the fact that practically all of the two 80-acre tracts in quarter sections S–8 and S–12 have been proven by wells

Nos. 3 and 4, driven by C and D Cos., the A Co. is allowed a full discovery exemption on each of these 80-acre tracts, because the company had the lease before wells Nos. 3 and 4 were brought in.

The E Oil Co. now acquires the 80 acres lying east of A Co.'s quarter section S-16. (The shaded area on the diagram.) They bring in well No. 7 and get the discovery exemption, because it is outside of any 160 acres proven area. This well No. 7 proves practically 80 acres of A Co.'s quarter section S-16, but nevertheless this latter company on drilling their well No. 8 close by, gets the discovery exemption because the lease was acquired before the E Co. brought in well No. 7.

A Co. now drills well No. 9 between quarter sections S-7 and S-8, and well No. 10 between quarter sections S-11 and S-12, to prevent losing discovery depletion under the regulation which provides that a discovery will not be allowed when the area is entirely surrounded by proven areas. Through wells No. 9 and 10, therefore, the A Co. proves and gets the discovery exemption on all the oil under the 320-acre tract in which these wells are located.

This carries the illustration far enough to show how the entire area east of the original discovery well No. 1 can be blanketed with discovery exemptions. By the same process the areas north, south, and west of the original well can be blanketed until the limits of the pool are reached.

On the diagram we have carried the process out by putting in wells Nos. 11 to 43, inclusive, and showing additional leases F to R, inclusive. The diagram is self-explanatory.

By judicious drilling, then, the A Co. can get the discovery exemption on their whole 2,560 acres with the exception of the 10 acres subleased; and they can do this without making a single real discovery and without taking any real risk in drilling. Out of the 2,560 acres under lease by the A Co. the discovery exemption is actually allowed on 1,270 acres which have been proven by others even on the arbitrary 160-acre rule of the bureau.

The map on the opposite page shows how H. V. Foster actually blanketed a 640-acre tract with 10 "discovery" wells (2901-2902).

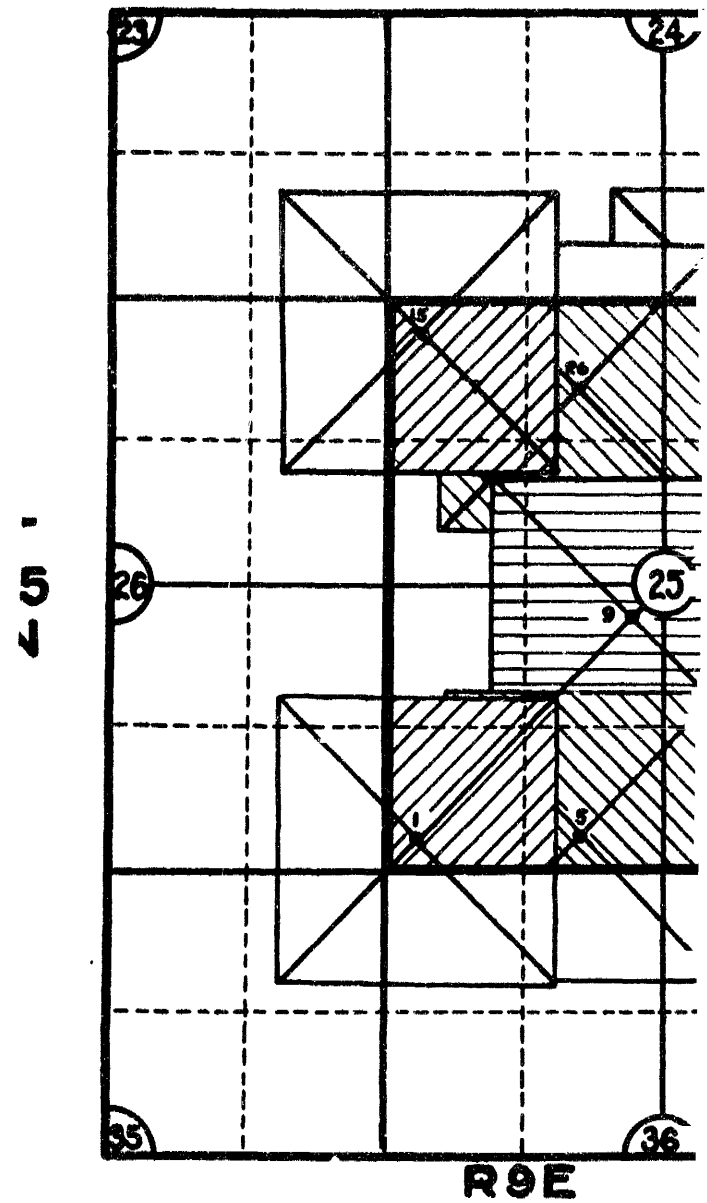
Foster acquired a lease on section 25, range 25-9, Osage County, Okla., on December 16, 1910, for which he paid no bonus. Through these 10 discoveries on this 640-acre tract he has secured discovery exemption amounting to $2,231,329.

The order in which the wells were brought in, the acreage within Foster's lease proven by each well, the discovery exemption allowed, and the general location of the discovery areas are as follows:

Order	Well No.	Acreage proven	Discovery exemption	General location on section
First	1	49.5	$3,554.10	Southwest corner.
Second	5	56.0	148,449.28	Directly east of well No. 1.
Third	9	123.25	161,146.72	Center of section.
Fourth	15	60.0	201,755.93	Northwest corner.
Fifth	16	49.0	467,447.50	Southeast corner.
Sixth	19	7.5	112,451.38	South side between wells 5 and 6.
Seventh	23	96.25	339,729.12	Center of east side.
Eighth	26	67.0	302,990.29	Center of north side and small square and between 15 and 9.
Ninth	27	34.3	236,238.00	Northeast corner.
Tenth	35	18.0	57,567.50	North side between wells 26 and 27.

Section: 25 Township: 25

County: Osage St



H.V. Fc

Discoveries

to

Jan. 1,

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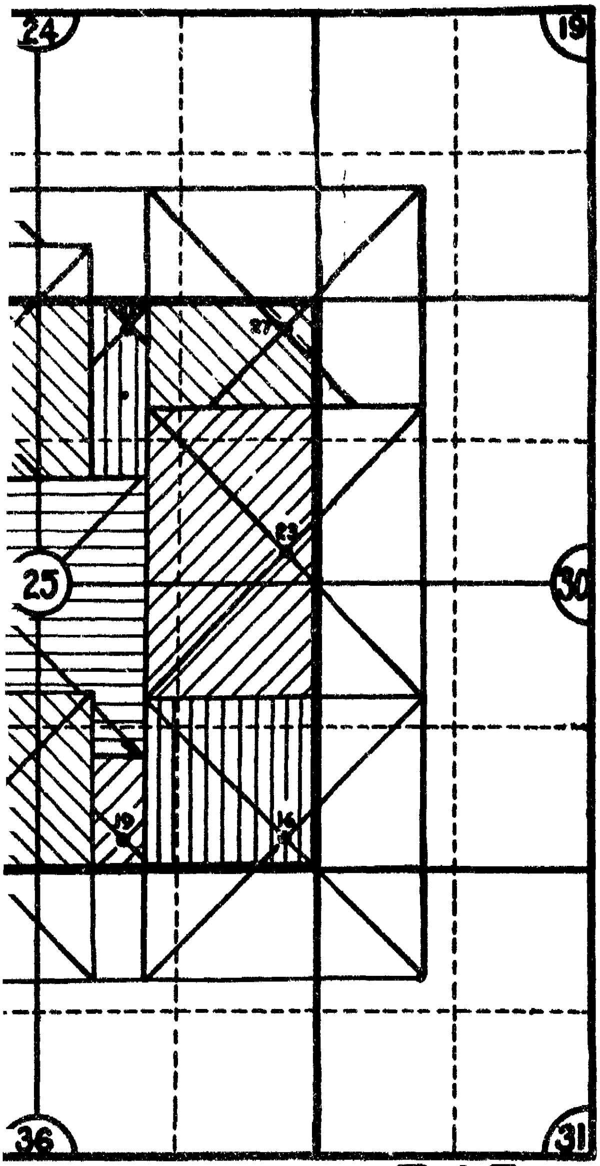
State - Oklahoma



. Foster

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to

1, 1922.

OVERSIZE PAGE

At this place in the printed edition of this volume there is an oversize page. It and all other similar pages in the collection are to be found under the heading:

OVERSIZE PAGES

GREENWOOD PUBLISHING CORPORATION, WESTPORT, CONNECTICUT

Foster secured discovery exemption on 560 out of 640 acres, and the remaining area is so situated that a producing well, located at any point on it, will permit the allowance of a discovery value and thus blanket the entire section with discovery areas.

A chart on page 2904 of the hearings shows how Foster, up to January 1, 1922, had blanketed 626 out of 960 acres contained in another lease, and will be still able to blanket the remaining 334 acres with discoveries when the remaining acreage is drilled.

The map on the opposite page shows the results of a study of 35 continguous quarter sections in the Winona pool located in Osage County, Okla. The line-shaded areas show the discovery values which have been allowed by the Income Tax Unit to and including 1920. The dotted areas show tracts within a 160-acre area proven by a well brought in on an adjoining tract before the date of the acquisition of the lease. Such tracts are not eligible for discovery valuation. The unshaded areas indicate the tracts upon which the taxpayer's right to discovery value has not been acted upon by the unit. When the claim for the years subsequent to 1920 are acted upon, it is probable that additional discovery allowances will blanket the unshaded areas to the same extent as are indicated by the shaded areas. A full explanation of this map and the data upon which it is based are found in the hearings beginning at page 2835.

FOURTEEN DISCOVERY WELLS AND 745 ACRES PROVEN AREAS ON 160-ACRE TRACT

The diagram on the opposite page shows discoveries allowed on the Lee Sawyer lease of the Gypsy Oil Co., located in Nobl ounty, Okla.

This case illustrates how a compact area can be blan different discoveries, and how successive discoveries can owed on the same area (2907). This lease cost $5,700, and discovery exemption to the extent of $9,573,875 is being claimed on it.

This lease covers 160 acres and is a typical case, showing how discovery may be obtained on more than one sand. So far 14 discoveries have been drilled on this 160-acre area, 13 of which have been set up as discovery wells. As two discoveries are claimed on well No. 1, 14 discoveries are claimed on this quarter section.

It will be noted that well No. 75, in the center of the tract, is made the basis of a claim for discovery value, in the third sand, over the entire 160-acre area.

In the fourth sand, discovery value is claimed on the entire 160 acres through wells 8, 18, and 52.

In the fifth sand, discovery value is claimed on the entire 160-acre area through wells 3, 5, 6, and 28.

In the second sand, discovery value is claimed on 145 acres through wells 1, 21, and 42.

In the first sand, discovery value is claimed on 120 acres through wells 1, 11, and 37.

On No. 1, well discoveries are claimed for two 40-acre tracts, one in the first sand and one in the second sand.

If the taxpayer had stopped well 42 in the first sand, before going on to the second sand, as it did well No. 1, an additional discovery of 40 acres could have been claimed in the first sand. If it had stopped well 18 in the second sand, before going on to the fourth sand, it could have picked up the 15 acres upon which no discovery is claimed in the second sand. The taxpayer could then have claimed discovery value on 800 acres, within this quarter section, and still have been within the law and regulations.

It is recommended that if discovery depletion is not entirely eliminated, a proven area be defined in the law as the area indicated by geological conditions to be within one oil pool, and that the determination of the limits of the proven area be made by the United States Geological Survey.

Illegal Allowance of Discovery Depletion and Records to Check Discovery Areas

The three conditions under which discovery value can not be allowed for depletion purposes under the regulations are as follows:

1. Where the area, upon which discovery depletion is claimed, is included in an area in the same sand upon which a discovery value has already been allowed.

2. Where the tract upon which discovery is claimed was a proven area at the date of acquisition by the taxpayer.

3. Where the tract upon which discovery is claimed was surrounded by proven areas at the date of acquisition.

It is obvious that some system of maps or tract indices, showing discovery areas claimed and allowed, is required to determine whether a discovery area claimed falls under one of the three conditions under which it is not allowable. No such record is maintained by the Income Tax Unit.

The discovery areas allowed in a portion of one oil pool were checked by the committee's engineers, and one illegal allowance of discovery depletion was located. The areas investigated for this purpose are shown on the map of the Winona oil pool in Osage County, Okla., which appears opposite page 41 hereof.

The Texas Co. was allowed a discovery value on 70 acres in the south half of the northwest quarter of section 18. Thirty-five acres of this area had been proven by a well in the southeast corner of the northeast quarter of section 13, brought in by the Finance Oil Co. on June 13, 1919, and by a well in the northwest corner of the southwest quarter of section 18, brought in by the Twin State Oil Co. in September, 1919. The Texas Co. acquired its lease in October, 1919, and, as to 35 acres, it thus acquired a proven tract or lease upon which discovery depletion is not allowable under the law (2842–2843).

No tract records being kept by the Income Tax Unit, a complete check to determine the extent of such illegal allowances would require an examination of every case and the building up of a set of tract records. The committee's engineers made no attempt to go further than to establish the fact that the Income Tax Unit has established no system for the detection and disclosure of illegal claims for discovery.

Valuation Methods Employed

The methods of determining the values of natural resources, as of basic date, for depletion and invested capital purposes may be divided into three classes as follows:

1. Valuations based upon comparative sales.
2. The valuation of the present value of royalties.
3. The valuation of estimated expected operating profits, commonly called the analytic method.

COMPARATIVE SALES METHOD

This method may be illustrated by assuming that the value of a deposit of gravel, as of March 1, 1913, is required. The contents of the deposit are estimated to be 100,000 tons.

There is data available, showing that A sold a gravel pit, estimated to contain 50,000 tons, in February, 1913, for $1,000; that B sold a gravel pit containing 150,000 tons in June, 1913, for $3,750; and that C sold a gravel pit containing 150,000 tons in July, 1913, for $2,250. These properties are selected for comparative purposes because they are in the same locality, have approximately the same freight rates, and can be operated at about the same expense per ton of gravel sold, as the property to be valued.

Tabulating these three comparative sales we have the following:

Property	Total tons	Total price	Sale price per ton (cents)
A	50,000	$1,000.00	0.02
B	150,000	3,750.00	.025
C	150,000	2,250.00	.015
	350,000	7,000.00	[1] 02

[1] Average unit sale price.

The value of the pit in question is then determined by multiplying its estimated contents, 100,000 tons, by 2 cents, and the value is found to be $2,000.

If it is found that one of the deposits used as a comparative had operating or transportation advantage not possessed by the deposit to be valued and by the other comparative, the sale price per ton of that comparative is adjusted to make it comparable with the other deposits.

This method determines the average replacement cost of the deposit, as the value to be depleted, or allowed as invested capital, and includes no elements of value, except the cost of replacing, as of basic date, the material which is consumed in the operation of the business.

This method is the one which has been generally applied by the nonmetals valuation section in determining the value of such nonmetal deposits as sand, gravel, clay, stone, etc.

PRESENT VALUE OF ROYALTIES

Where deposits are commonly leased for exploitation on a royalty basis, such as is the case with bituminous coal and in some cases stone, clay, etc., the value is determined by determining the present value of royalties.

Assume that the prevailing royalty rate, at which deposits of Pocahontas coal could be leased for mining purposes in 1913 was 17.9

cents. Assuming also that the property contains estimated reserves of 5,000,000 tons, which is being mined at the rate of 500,000 tons per year, the life of the property is 10 years. The value of the deposit of an operating owner, a lessor or a lessee is determined as follows:

VALUE OF LESSOR'S INTEREST

The value of the rights of a lessor as of March 1, 1913, in a mine then under lease, is measured by the present value, as of March 1, 1913, of the royalties to be received. If the property had been leased at a royalty of 10 cents per ton in 10 years, the lessor will receive royalties of $500,000 on 5,000,000 tons. The value of the lessor's interest, as of March 1, 1913, is the present value of $500,000, discounted for 10 years at the discount rate accepted as representing the risk involved.

As the royalty stipulated in the lease is very much below the prevailing royalty rate as of March 1, 1913, the recovery of this low royalty rate involves very little hazard, and we will assume that 6 per cent is a fair rate of return on this investment. Hoskold's present value tables are in general use by the Income Tax Unit. According to these tables, the present value of $1, accumulated in equal installments for 10 years, discounted at 6 per cent, and allowing 4 per cent on sinking fund accumulations, is $0.6979. This factor applied to the $500,000 royalties, to be recovered in 10 years, gives a present value of $348,940.40, which represents the value of the deposit.

VALUE OF LESSEE'S INTEREST

The value of the lessee's interest in the property, in which the lessor's interest has been valued above, is the present value of the saving he will realize in 10 years, because of the fact that on March 1, 1913, he has a lease to mine coal at a 10-cent royalty, while the prevailing royalty is 17.9 cents. This saving of 7.9 cents per ton attaches to 5,000,000 tons of coal. The total saving in 10 years is $395,000.

There is more risk involved in recovering a value of 17.9 cents per ton, so the discount rate should be higher than the 6 per cent used in discounting the value of the lessor's interest. As the value is based upon the prevailing royalty for coal in place in the mine and not upon profits estimated to be recoverable from mining and selling coal, we will assume that this lease could be sold to a buyer, who expects to lease the property at the prevailing royalty rate of 17.9 cents per ton, and expects to receive back what he pays for the lease and 8 per cent on his investment. Hoskold's tables give 61.24 as the present value factor, at 8 per cent and 4 per cent for 10 years. Thus the total differential between a 10 cents royalty and a 17.9 cents royalty of $395,000 has a present value of $241,898.

VALUE OF OPERATING OWNER'S INTEREST

The operating owner's interest is valued by the same method as that applied in valuing the interests of a lessor or a lessee, except that it is based upon the present value of the prevailing royalty of 17.9 cents per ton.

ANALYTICAL APPRAISALS

By the analytical method of determining value the operating profits to be realized are estimated and discounted for the period of deferred realization.

The factors to be considered and the formula for determining the value of a mineral property by an analytic appraisal are stated in Regulations 62, as follows:

ART. 206 (b). "To determine the fair market value of a mineral property by the present value method, the essential factors must be determined for each deposit included in the property. The factors are (1) the total quantity of mineral in terms of the principal or customary unit (or units) paid for in the mineral product marketed, (2) the average quality or grade of the mineral reserves, (3) the expected percentage of extraction or recovery in each process or operation necessary for the preparation of the crude mineral for market, (4) the probable operating life of the deposit in years, (5) the unit operating cost, i. e., cost of production exclusive of depreciation and depletion, and (6) the rate of interest commensurate with the risk for the particular deposit. When the deposit has been sufficiently developed these factors may be determined from past operating experience. In the application of factors derived from past experience full allowance should be made for probable future variations in the rate of exhaustion, quality or grade of the mineral, percentage of recovery, costs of production, and selling price of the product marketed during the expected operating life of the mineral deposit.

ART. 206 (e) The number of units of mineral recoverable in marketable form multiplied by the difference between the selling price and the operating cost per unit gives the total expected operating profit. The value of each mineral deposit is then the total expected operating profit from that deposit reduced to a present value as of the basic date at the rate of interest commensurate with the risk for the operating life, and further reduced by the value at the basic date of the depreciable assets and of the capital additions, if any, necessary to realize the profits. The degree of risk is generally lowest in cases where the factors of valuation are fully supported by the operating record of the mineral property prior to the basic date; relatively higher risks attach to appraisals upon any other basis."

As a typical example of an analytic appraisal, an actual appraisal of a copper mine made by the metals valuation section is used.

Valuation of a copper mine as of March 1, 1913

1. Estimated number of pounds of recoverable copper Mar. 1, 1913	59,976,212
2. Estimated expected sales price per pound	$0.1512
3. Estimated expected cost of operation per pound	$0.1000
4. Estimated operating profit per pound (2–3)	$0.0512
5. Estimated total operating profit (4×1)	$3,070,782
6. Estimated period required to exhaust deposit ... years	15
7. Estimated expected rate of return per annum ... per cent	8
8. Hoskold's present worth factor for 15 years at 8 per cent and 4 per cent	$0.513053
9. Present worth of expected profits (5×8)	$1,575,474
10. Estimated plant cost	$500,000
11. Values of ores only, Mar. 1, 1913 (9–10)	$1,075,474

DEPLETION OF INTANGIBLE PROPERTY

Much confusion in the Income Tax Unit and goss discrimination between taxpayers has resulted from the conflict between the regulations and rulings and the practices in the Income Tax Unit as to the allowance of depletion upon intangible values. An amendment of the law appears necessary to prevent discrimination among taxpayers in this respect.

The law provides that the allowance for the depletion of mines, etc., shall be based upon the "fair market value" of the "property." The law does not say whether the "property," the value of which is to be the basis of depletion, is merely the tangible deposit of mineral, sand, gravel, or coal which can be taken from the mine and sold or whether the depletable property is the taxpayer's business as a going concern. If the property to be depleted is the taxpayer's business as a going concern, intangible property, represented by the value of having capital assembled, the use of working capital, a management and organization with which to operate, and, in many cases, good-will, are included in the value to be depleted, in addition to the tangible property, represented by the physical deposit.

If the analytic or present-value method of determining fair market value is used, the value determined is the assumed present value of all of the profits to be derived from the business. Such a value reflects every element which influences profits, including the use of working capital, the value of having capital assembled, the efficiency of the management, the knowledge of and use of manufacturing processes, the possession of a manufacturing and sales organization, and good will. Such a value includes not only the value of the tangible physical property but the value of the business ability of the owner of the business. The only deduction made from this value, to determine the amount which is to be returned tax free as depletion, is the amount of the depreciable assets which are returned tax free as depreciation.

In any business requiring a large amount of working capital the amount of the working capital, as well as the present value of such profits as may be derived from good management, manufacturing processes, salesmanship, and good will, are included in the value given to the property to be depleted.

If the "fair market value" of the "property" is determined upon a cost of replacement basis, or by determining the present value of the difference between a royalty, fixed in a lease, and the going market royalty rates, all elements of value, other than the value of the bare physical property or lease, are excluded from the value to be depleted.

Article 206 of Regulations 65 and all former regulations provide that:

> Valuations by analytic appraisal methods, such as the present-value method, are not entitled to great weight: (1) if the value of a mineral deposit can be determined upon the basis of cost or replacement value, (2) if the knowledge of the presence of the mineral has not greatly enhanced the value of the mineral property, (3) if the removal of the mineral does not materially reduce the value of the property from which it is taken, or (4) if the profits arising from the exploitation of the mineral deposit are wholly or in great part due to the manufacturing or marketing ability of the taxpayer, or to extrinsic causes other than the possession of the mineral itself. Where the fair market value must be ascertained as of a certain date, analytic appraisal methods will not be used if the fair market value can reasonably be determined by any other method.

This regulation has been observed in both letter and spirit by the chiefs of the metals, nonmetals, coal, and timber valuation sections who were in office during the progress of this investigation. It has been the practice of these valuation sections to determine values to be depleted on the basis of the cost of replacement of the deposit.

Precedents established by the head of the engineering division and by the committee on appeals and review, in reversing decisions of the nonmetals section, in effect nullify the above-quoted provision of the regulations and practically leave it optional to include or exclude intangible values. The inclusion or exclusion of such intangible values depends entirely upon the method of appraisal followed, and it is only necessary to ignore the evidence of value based on comparative sales to secure depletion on intangibles through an analytic appraisal.

Thus the inclusion or exclusion of intangible property in the value to be depleted depends upon the method employed in appraising the value of the property to be depleted.

The income-tax law provides that a taxpayer shall be entitled to a "reasonable" deduction for depletion, to be based upon the value of the property on the basic date. While the word "property" is not defined by the law, it is obvious that it is to be given the same meaning, regardless of the appraisal methods employed to ascertain its value. It is obvious that the "property," the value of which is to be the basis of the depletion allowance, is the "property" which is actually depleted in producing the income to be taxed. It is also obvious that the right of a taxpayer to an allowance for the depletion of his intangibles, in computing taxable income, should not be dependent upon the opinion of an employee of the Income Tax Unit as to the practicability of applying a valuation method.

A valuation of property, including the intangibles, results in a very much higher depletion allowance than a valuation based upon the cost of replacing the physical property which is depleted. Owing to the different views of officers and employees of the unit as to the practicability of determining cost of reproduction, the grossest kind of discrimination has resulted from this situation.

United States Graphite Co.

(1342)

The United States Graphite Company case furnished an excellent illustration of how the valu*ɔ* of good will can inflat depletion.

This company mines graphite in Mexico. The raw graphite is shipped to the taxpayer's plant at Saginaw, Mich., where it is ground and refined.

The ground refined graphic is used to make the fillers in lead pencils, and it is also the raw material used in the manufacture of foundry facings, paints, lubricants of all sorts, motor and generator brushes, electrical supplies, stove polish, boiler graphite, and graphite for electrotyping, powder glazing, and other purposes. This company has built up a world-wide business and has a practical monopoly on the furnishing of graphite for the manufacture of lead pencils in the United States, in addition to which it exports large quantities of ground refined graph.te to England, France, Germany, and Japan.

In 1893 this taxpayer acquired its first Mexican mine, in exchange for $35,000 par value of its stock.

The taxpayer claimed a March 1, 1913, value on this mine, for depletion purposes (1342), of $516,926.45. Mr. A. R. Shepherd, a special conferee, designated by and working directly under Mr. S. M. Greenidge, head of the engineering division, was permitted to overrule the normetals section and allowed a March 1, 1913, value of $1,043,044.56 (1348).

This value was determined by deducting the average cost per ton of mining, shipping, manufacturing, and selling refined ground graphite from the average selling price to determine the expected profit per ton. The expected profit was determined to be $46.42 per ton. The expected profit per ton was then multiplied by the estimated number of tons of graphite in the mine on March 1, 1913, to determine the total expected profits to be realized during the life of the mine, which was estimated to be 28 years. The total expected profits were then discounted to present value, as of March 1, 1913, giving $1,043,044.56 as the value of the mine on that date. The value was then divided by the estimated tonnage in the mine to get the depletion unit which was determined to be $11.14 per ton.

It will be noted that this valuation is based upon all profits of the business, not only from mining the graphite, but also from refining and grinding it, at the Saginaw factory, and selling it to a trade extending all over the world.

In 1918 the taxpayer purchased a new deposit, 27 miles nearer to the railroad, and containing the same quality of graphite, for $37,000, cash. In 1920, the operation of the deposit, which had been valued at $1,043,044.56, was abandoned, because the new deposit, purchased in 1918 for $37,000, could be more economically operated. Mr. Shepherd stated that the value of $1,043,044.56, placed on the old mine, was due to the market which had been built up by this company for its product (1354–1355).

By this method of determining depletion, depletion is allowed upon the value of a world-wide good will, yet the value of that good will to the taxpayer was in no way affected by the depletion of the old mine. It could buy a new deposit to replace the old and continue to enjoy the value of its good will. This is exactly what it did do in 1918, when it purchased the new mine. So long as other deposits existed in 1913, which were available for purchase, the value of the capital consumed by taking graphite from the old mine could not exceed the cost of replacing that graphite by acquiring a new deposit.

While no figures are available showing the exact amount by which the value of good will entered into this valuation for depletion, some idea of the minimum can be obtained from the value placed upon this graphite by the taxpayer for customs purposes. This taxpayer has declared an average value of $7.32 per ton at the border for customs purposes. This $7.32 includes the cost of mining, hauling 27 miles by wagon to the railroad, and freight from the point of loading to the border. It thus appears that the value of this graphite in the mine, which is all that is actually depleted, could not exceed a small fraction of $7.32. Yet the amount of depletion per ton allowed is $11.14, or $3.82 more than it is declared to be worth, after it has been mined, hauled 27 miles in a wagon, and shipped by rail to the border.

The average selling price of this graphite is $113.86 per ton (1307). The average profit used as the basis of this valuation is $46.42. The average cost of mining, transporting, manufacturing and selling would thus be $67.44 per ton. As all the costs incurred in Mexico can not exceed the value at the border, or $7.32, and the cost of freight is computed at $10 per ton, at least $50 per ton must be incurred for manufacturing and selling the product. This valuation, however, attributes no profit to manufacturing and selling, but throws the whole profit of $46.42 per ton back into the value of the mine.

The per ton value of the graphite in the ground can not exceed its value at the border. Using the same method and factors as were used in getting the value of $1,043,044.56, except the profit per ton, which we will assume to be $7.32, will give a value of $203,901.04 and a depletion unit of less than $2.18 per ton instead of $11.14.

Thus, if we assume that it cost nothing to mine this graphite, haul it 27 miles by wagon to the railroad, and ship it by rail to the border, and that its entire value at the border was profit, the value of the mine could not exceed $203,901.04, and $839,143.52, or 80 per cent of the value allowed, was attributable to the manufacturing and sales profits, earned after the raw material was shipped into the United States. For every ton of graphite sold, this taxpayer received more than $8.86 for the depletion of good will, which was actually not depleted at all, because a new deposit could be acquired, as it was acquired in 1918, in the operation of which the good will is being utilized.

The number of tons sold in 1917, 1918 and 1919, the depletion allowance, based on the depletion unit allowed by the Income Tax Unit, and the depletion which would be allowed, assuming that $7.32 per ton represents the value in the mine, are as follows:

Year	Tons	Depletion at $11.14	Depletion at $2.18
1917	5,006	$55,766.84	$10,913.08
1918	5,758	64,144.12	12,552.44
1919	3,646	40,616.44	7,958.28

It thus appears that there was allowed, as tax-free deductions, for the depletion of the 1913 value of expected manufacturing and selling profits at least $44,853.76 in 1917, $51,519.68 in 1918, and $32,658.16 in 1919.

As this taxpayer could and did replace its 1913 deposit in the ground by the acquisition of an additional deposit, it was no differently situated than any merchant or manufacturer. It laid in a greater supply of raw material than is laid in by the ordinary merchant or manufacturer, but the exhaustion of the 1913 stock could not terminate its business.

The greater portion of its expense was incurred in manufacturing and selling its product, and 80 per cent of its profit was earned after its raw material left the customhouse on the border. This profit can not be differentiated in principal from the profit of any other manufacturer. No merchant or manufacturer who had an established business on March 1, 1913, is permitted to set up the present value, as of March 1, 1913, of all the profit he expects to derive from the business he then owned, and have such value returned to him tax free as a deduction from the income as it is earned. To permit the deduction of manufacturing and selling profits from the income of a manufacturer and merchant who buys his raw material in the ground instead of f. o. b. cars is a gross discrimination.

CLIMAX FIRE-BRICK CO.

(1360)

This taxpayer is a manufacturer of fire brick used to line furnaces, and, by reason of the superiority of its products, has established a large and profitable business.

In this case, the value of the good will, the possession of the capital and manufacturing ability of the taxpayer is attributed to the value of a lease to mine fire clay. The taxpayer is then permitted to deduct the value thus attributed to this lease from taxable income in equal annual installments over the life of the lease. While this allowance is not called depletion, it is in effect a depletion allowance but distributed contrary to the regulations.

The lease was for a 20-year period, beginning in 1899, and permitting the mining of fire clay to be used in the manufacture of fire brick. The royalty stipulated in the lease was 25 cents per ton for one grade of clay and 15 cents per ton for another grade. No bonus was paid for this lease. In 1907 the taxpayer leased an adjoining property containing the same quality of clay upon the same royalty basis without bonus. The lease in question contained no renewal provision but was voluntarily renewed when it expired in 1919, without the bonus at the same royalty.

This lease was given a value as of 1900 of $154,120.70, and deductions of $8,368.54 were allowed from the income of both 1917 and 1918.

Prior to the incorporation of this taxpayer the business was operated as a partnership for a period of 15 months. No value was attributed to the lease when it was assigned to the partnership.

The profit of the partnership period was determined to be $1.38 per ton of clay mined. This profit was inclusive of all profits derived from the business. The valuation was determined by multiplying the estimated tonnage which would be mined by $1.38 to get the total expected profit during the life of the lease, and by then reducing this amount to a present value as of 1900 by an 8 per cent annual discount. This method of valuation attributed to the lease the total value of the profits arising out of manufacturing and selling the product.

The fact that during the life of this lease another lease was acquired upon the same royalty and without bonus, and this lease was voluntarily renewed without bonus or increase of royalty proves conclusively that the royalty paid covered the full market value of the right to mine clay. If this lease could be replaced by another without cost upon the same terms as it was, it could have no value as capital consumed by either the mining of clay or the lapse of time.

The average royalty provided in this lease was 20 cents per ton. Paying this royalty, the taxpayer made a net profit of $1.38 per ton. Assume that the royalty stipulated had been 40 cents per ton. This increase in royalty would still leave a profit of $1.18 per ton. If $1.18 is substituted for $1.38 as the profit per ton, the method used in this case would give a value of $131,784.24 to this lease. Now, assume that the taxpayer could have acquired another lease on a 20-cent royalty basis. It is clear that a lease calling for a royalty of twice what the clay would be bought for from others would be a liability instead of an asset, yet this method of appraisal would show it to be a depletable asset of the value of $131,784.24.

A lease of either the use of property for a rental or of the right to mine for a royalty can have a value as capital only when the stipulated rental or royalty is less the rental or royalty which would be required to replace the property leased. If a lease requires the payment of greater rental or royalty than would be required to replace the property, it is a liability instead of an asset.

In the case under consideration the property was replaced at the same royalty, which shows that its value was equal to the royalty paid, and the lease was neither an asset nor a liability.

The taxpayer in this case claimed that the value of this clay was greater to it than to the owner of the fee because the owner of the fee had neither the capital nor the ability to manufacture. This is conclusive that the entire value set up to be deducted from income was the intangible value of the possession of capital and the ability to manufacture and sell the product. As the deposit was replaced the value of these intangibles was not decreased by the exhaustion of the material acquired under the lease and was not a proper basis for a deduction from income.

Mr. S. M. Greenidge, head of the engineering division, approved a value of $200,456 on this lease over the protest of Mr. Briggs, chief of the nonmetals valuation section (1364). This value was arrived at by using prospective profits for 40 years as the basis of the value of a 20-year lease, and was approved by Mr. Greenidge after his attention had been called to all of the facts in the case (1363, 1364).

The reasons assigned for this action are stated in a memorandum signed by A. R. Shepperd, special conferee, as follows (1379):

> This action was taken by the section upon instructions from the undersigned special conferee.
>
> A 40-year life was allowed in spite of the fact that the taxpayer only held a 20-year lease at organization, for the following reasons:
>
> 1. Taxpayer maintained that a custom, amounting almost to unwritten law, existed in his district which provides that any lessor is given the privilege of renewal at the end of his lease.
>
> 2. Taxpayer demonstrated that he had obtained control of all the surrounding property in such a way that the fee owner would not have been physically able to lease the property to anyone else without his (the taxpayer's) consent.

It was only after a protest from the audit division (1380) that Mr. Greenidge consented to a reduction of the profits valued to those falling within the 20-year term of the lease.

HOUSTON COAL & COKE CO.

(3141-3146)

On March 1, 1913, this taxpayer was the holder of a lease to mine bituminous coal for a royalty of 10 cents per ton. On March 1, 1913, bituminous coal leases could be obtained in any quantity at 17.9 cents per ton royalty. The royalty rate stipulated in the lease in question being 7.9 cents below the prevailing rate of market price of coal in the mine, gave this lease a value as of March 1, 1913. The value of this lease was due entirely to and measured the difference of 7.9 cents between the stipulated royalty and the going royalty rates on March 1, 1913.

The value as of March 1, 1913, was computed by the Income Tax Unit engineers at $200,116.92, which gave a depletion unit of $0.04966 per ton. This depletion unit is equal to the present value of 7.9 cents discounted at 8 per cent for 12 years, the life of the mine.

Instead of determining the value of this lease on the basis above described, it was determined by estimating the present value of the entire estimated profits to be derived from the business of mining and selling coal under this lease. On this basis the lease is given a value of $918,884.60 and the depletion unit is 21.3 cents. As a royalty of 10 cents was stipulated in the lease, the coal in the ground was thus valued at 31.3 cents, when it was an established, undisputed fact, agreed to between the Income Tax Unit and the Pocahontas operators, that the market price of coal in the ground on March 1, 1913, was 17.9 cents.

It is an undisputed fact that the principal element of profit in mining bituminous coal is the ability to sell the product. In both valuations the same reserves, life and discount rate are used, so that the difference in value and in the depletion unit is due entirely to the valuing of the saving in royalty in the first valuation and the prospective profits in the second. In this case nearly $718,000 of value due entirely to good will and selling ability is attributed to coal in the ground and returned to the taxpayer as tax-free depletion.

NEW JERSEY CALCITE CO.

On January 6, 1923, the Committee on Appeals and Review, the apppellate authority of the Income Tax Unit, placed its stamp of approval upon the depletion of intangible values due to prospective manufacturing and sales profits by its unpublished recommendation No. 1517 (1299).

In April, 1916, Benjamin Nicoll, who was engaged in the business of quarrying stone used as smelter flux, incorporated his business under the name of the New Jersey Calcite Co. and turned the business over to the taxpayer in exchange for $150,000 par value of its stock.

Included amoung the assets of the business transferred to the corporation were three leases permitting the removal of stone on a royalty basis. One of these leases permitted the removal of stone for a royalty of 4 cents per ton for a period of five years after incorporation. One lease running for eight years and another running for two years provided for a royalty of 3 cents per ton (1294).

The taxpayer claimed a value of $130,000 on these leases as of April, 1916, to be depleted in annual installments between April, 1916, and the expiration of the leases.

In the brief submitted by the taxpayer the records of three leases made in Sussex County, N. J., the same county in which the property of the taxpayer is located, are set out as follows (1294):

November 9, 1916, Sussex Calcite Co. to Sussex Limestone Product Co. royalty not less than 4½ cents and not over 5 cents per ton.

October 2, 1918, Lucy E. Lliff, etc., to Bernard Stener, royalty 5 cents per ton.

March 16, 1920, Franklin Mineral Co. to Whorton Steel Co., royalty 5 cents per ton. This lease was made by one of the lessors to the taxpayer and the quarry covered by this lease is in the same belt of limestone and is worked in the same manner as the quarry covered by the lease to the taxpayer.

It will be noted that the first of these leases was made within a few months of the date as of which the taxpayer's lease was valued and the two subsequent leases show that even as late as October, 1918, and March, 1920, the royalty value of limestone in the quarry had not raised above 5 cents per ton. In the absence of any showing that there had been a temporary inflation in royalty values in April, 1916, these leases conclusively fix the maximum market value of the unquarried limestone covered by the taxpayer's leases in April, 1916, at 5 cents per ton. There was no such showing. The royalties fixed by the taxpayer's leases of 3 and 4 cents prior to 1916 and the 4½ and 5 cent royalties fixed in these subsequent leases was the only evidence of royalty rates in this neighborhood before the Bureau of Internal Revenue.

From the above it is apparent that the only market value in the leases of the taxpayer on the basic date, April, 1916, was due to an advantage of royalty rate of 2 cents per ton for one lease for eight years and for one lease for three years, and of 1 cent per ton for one lease for five years. On this basis the valuation engineers fixed the value of these leases at $8,950.93 (1294, 1295).

The taxpayer appealed from this determination to the Committee on Appeals and Review, which allowed a value of $106,000 on these leases (1299). This value was based upon prospective profits (1273) of approximately 20 cents per ton instead of 1 and 2 cents.

A verbal protest was made by the valuation section, upon the ground that this basis of determining the value of such a lease was contrary to the established practice of the valuation section and would necessitate the reversal of prior rulings and decisions (1273).

In response to this protest, on January 4, 1923, the following memorandum was sent to the valuation section (1237):

Memorandum for Mr. J. H. Briggs, chief nonmetals, valuation section, room 5038.

I have gone over with other members of the committee the case of the New Jersey Calcite Co. since the discussions I had with you concerning it, and we have come to the conclusion that the valuation heretofore fixed upon the leasehold of the taxpayer was based upon the only admissible evidence before us and consequently should be allowed to stand.

The finding in this case does not in my opinion necessitate or involve any change in procedure in the natural resource division nor any modification of its rulings. The method used in arriving at a value in this case was resorted to because there was no other admissible evidence in the case, and for this reason the case should be considered as having been decided upon its own facts and should not be treated as a general precedent.

A. W. GREGG,
Chairman, Special Committee on Appeals and Review.

The decision of Mr. Gregg that there was no admissible evidence of the value of these leases in this case except the prospective profits of the taxpayer is a ruling that the royalties stipulated in similar leases in the same neighborhood before and after the date as of which value is to be determined is not admissible evidence. In this connection it will be borne in mind that such transactions show no fluctuations in value but a raise from several years before the basic date until a few months after the basic date, when they became and remained settled at 5 cents for at least four years. It will also be borne in mind that one of these leases was upon the same vein, where working conditions were identical, and another was only four months after the date as of which this value was determined.

This ruling practically nullifies the provisions of articles 206 and 207 of the regulations, providing that "analytic appraisal methods will not be used if the fair market value can reasonably be determined by another method," or "if the profits arising from the exploitation of the mineral deposit are wholly or in great part due to the manufacturing or marketing ability of the taxpayer, or to extrinsic causes other than the possession of the mineral itself."

If the evidence of comparative royalties was inadmissible in this case, there is no case to which any other than the analytic appraisal method can be reasonably applied. The profit arising from the possession of this stone was 1 and 2 cents, while the profit arising from sale was 20 cents. If a case where nine-tenths of the profit arises from causes other than the possession of the mineral does not come within the above quoted regulations, no case does.

Notwithstanding the fact that Mr. Gregg's memorandum says that the ruling in this case shall not be treated as a general precedent, it actually is a precedent. It is the precedent which constitutes the only justification for the determination of value made in the Penn Sand & Gravel case, in the Climax Fire Brick, in the United States Graphite case and many other cases, where deposits have been valued for the purposes of depletion by valuing the total expected profits of the business.

The ruling in the New Jersey Calcite case was vigorously defended by Mr. Gregg before this committee (1272). No inference can be drawn from his statements before this committee except that he considers this ruling sound. Mr. Gregg is now the Solicitor of the Bureau of Internal Revenue, and this ruling may be accepted as reflecting the views of the highest legal authority in the Bureau of Internal Revenue.

The official representatives of the bureau have repeatedly contended that the allowance of depletion upon intangible values is not the general practice of the valuation engineers (1385). The staff of the committee concede that it is not the general practice to allow such values.

The ruling of the Committee on Appeals and Review in the New Jersey Calcite case has never been published. The great body of taxpayers assume that the rule laid down by the regulations promulgated by the Commissioner of Internal Revenue, approved by the Secretary of the Treasury, and published for the guidance of taxpayers, measure their rights and are impartially enforced. Until this subject was brought to the attention of this committee, no one except the present and former employees of the Income Tax Unit were in a position to know that intangible values can be depleted. and that allowances including such values, amounting to from ten times to thirty times what could otherwise be obtained, have been made. It is bad enough to make such allowances to a few, but to deny the same relief to others similarly situated is even worse.

As the situation stands, the rule laid down by the regulations is generally enforced by the valuation engineers, but by the employment of a former employee of the unit a taxpayer can learn of the special relief being granted to some and insist upon and procure a like measure of relief. This illustrates the viciousness of unpublished rulings and of rulings which are not to be considered as precedents.

WITHERBEE-SHERMAN AND CO.

(3064)

This case illustrates in a most striking manner the effect of the inclusion of manufacturing profits in the value of ores in the ground.

The property involved is an iron mine located in the State of New York. The taxpayer operates a small smelter in which a very small part of the ore mined is converted into pig iron. The greater part of the ore is sold as ore and concentrates.

The metals valuation section valued this property as of March 1, 1913, for depletion purposes at the present value of the prospective profits to be derived from mining and selling ore and concentrates. On this basis a value of 38.9 cents per ton of ore was determined.

The Committee on Appeals and Review reversed the metals valuation section and allowed a value of $10,500,000 and a depletion unit of 62.97 cents per ton. This difference in depletion results in a difference in tax for 1917 and 1918 of $301,169.10. The same reserves and discount factor were used in both valuations. The only difference in the valuation is the expected profit per ton. The $10,500,000 valuation is based upon the profits, which are estimated as procurable if the taxpayer builds a blast furnace near New York City and converts its ore and sells it as pig iron. Thus, this valuation attributes to the ores in the ground the prospective manufacturing profits estimated be derivable from a blast furnace which does not exist and from a business in which the taxpayer is not even engaged. Exception has been taken to valuations of ore in the ground which included manufacturing and selling profits earned by taxpayers. In this case this element does not exist in the taxpayer's business but is imported into it for the sole purpose of inflating a value for depletion purposes.

Upon the theory applied in this case a valuation of a billion dollars could be justified by assuming that the taxpayer might go a few steps farther and convert his theoretical pig iron into theoretical watch springs.

The valuation of $10,500,000 was allowed by the committee on appeals and review on the ground that it was a valuation made at about 1913 and was the basis of an offer to purchase the property.

It appears from the record that in 1910 the Standard Oil Co. was contemplating the erection of a blast furnace near New York City and engaged an engineer to value the property of the taxpayer. This valuation for the Standard Oil Co. was based upon the expected profit to be derived from the ores from this mine when converted into pig iron and sold. In 1913 the taxpayer employed this engineer to bring his 1910 valuation down to date for tax purposes. This was done by eliminating the ore mined and by adding the ores developed between 1910 and 1913. The basis of determining profit was not changed. The valuation thus brought down to date was $12,500,000, including $2,000,000 for plant.

The record shows affirmatively that no offer to purchase this property was ever made by the Standard Oil Co., and it does not appear that the Standard Oil Co. ever even contemplated paying a price for the property which would include the value of all the profit they might expect to derive from the business of converting ore into pig iron. So long as manufacturers of pig iron can buy ore on the market at a price which includes only miner's profits, it is not reasonable to assume that they will pay for ore in the ground a price which includes the profit they expect to make from manufacturing.

In this case the metals valuation section was neither notified of nor represented at the hearing before the committee on appeals and review, and the ruling of the committee on appeals and review has never been published.

INTANGIBLE VALUES NOT PROPER SUBJECT OF DEPLETION

There can be no sound justification for treating prospective profits as capital to be deducted from income as depletion under any circumstances.

As has been stated the prospective profits of an established mercantile, banking or ordinary manufacturing business are not considered by the law, as capital on the basic date, to be deducted tax-free from the profits as realized. There is no logical distinction between such profits and those arising out of the capital manufacturing ability, selling ability, and good will of a manufacturer or trader who utilizes a natural resource as his raw material.

The realization of prospective profits involves the use of operating capital in addition to that invested in the deposit. By capitalizing prospective profits as value, the value of everything involved in the business, including the use of operating capital, is attributed to the value returned free of tax.

The realization of prospective profits requires the use of ability, experience, knowledge, judgment, skill, and attention. In all other instances, the profits, derived from the application of these human elements of the power to make money, are current taxable income, but when prospective profits are capitalized for depletion purposes, the value, arising out of the future exercise of money-making power, is treated as money already earned and invested in the business, and represented by a dead, inorganic mass of material in the ground.

The real value in such intangibles is nothing more than the value of the *opportunity* to utilize capital, good will, and human ability for the purpose of making a profit. While the principle is recognized that this opportunity is of some value, in cases where the raw material for an established business can not be replaced, it is believed that such cases are so exceptional, the practical difficulty of identifying them is so great, and such value is so speculative, indefinite, and uncertain that such intangibles are not a legitimate subject of depletion allowances.

It is therefore recommended that the depletion provision of the income-tax law be so amended as to define the subject matter of depletion as the tangible physical deposit and to prohibit the use of any valuation based on prospective earnings in all cases where the profits capitalized are to a material extent due to the manufacturing or marketing ability of the taxpayer or to extrinsic causes other than the possession of the mineral itself.

PROSPECTIVE PROFITS ONLY POSSIBLE BASIS IN SOME CASES

There are some deposits, such as gold, silver, copper, zinc, and lead, which are so dissimilar that it is impossible to determine their value on any comparative basis. In such cases there is no basis for determining depletion except prospective earnings. It is, however, a coincidence, that in such cases the mining profits, exclusive of any manufacturing or selling profits, are readily ascertained. These metals are sold in the bar, in a competitive world market, and their value, before being subjected to manufacturing processes, can be readily determined.

Attention is called to the fact that while the mining profits can be determined in such cases, the mining profits include the return upon operating capital, and if the amount of operating capital employed is not deducted from the value of the profits, the value of the deposit is inflated by the amount of operating capital employed in the business (1220).

DISCOUNTING TO PRESENT VALUE

To arrive at a sound valuation of any property by an analytic appraisal, the discount rate adopted must be equal to the rate of profit, which will induce capital to assume the risk involved in recovering the profit from the property.

It may be stated, as a general rule, that the discount rates which have been and are being used for valuation purposes by the Income Tax Unit are wholly inadequate, and that the tax-free allowances for depletion are correspondingly excessive.

The operating earnings of a depletable property are the gross receipts from the sale of the products, less the operating expense, exclusive of depreciation and depletion. These operating earnings include the value of the property subject to depletion and depreciation and whatever net profit is to be derived from the investment. Assuming that investors can be induced to risk their capital in a certain business when they can feel assured that there is a reasonable prospect of the return of their investment and a profit of 20 per cent per annum on such investment but that any less profit will not induce capital to enter that business, the required rate of return can be assumed to be 20 per cent per annum.

With the prospective profits estimated, and a required rate of return assumed, the value of the depletable and depreciable property may be assumed to be that amount, which, together with the required profits, will equal the anticipated operating earnings.

With the required rate of return and the anticipated profits assumed, the value as of any date can be determined, by discounting the anticipated operating earnings, at the required rate of return, for the period required for the realization of the anticipated operating earnings.

The required rate of return is called the discount rate, and the period from the date, as of which value is to be determined, and the date, when all of the anticipated operating earnings can be realized, by the exhaustion of the property, is called the "life."

With an assumed "discount rate," the amount to be deducted from operating profits, to determine the residue, representing the value of the property, depends upon the "life." The higher the discount rate, and the longer the life, the greater the amount, which will be required to provide the required profit, and the lower the value will be. Conversely the assumption of too low a discount factor, or of too short a life, will result in an excessive valuation of the property.

As the total value is returned tax free, in the form of deductions for depreciation and depletion, the amount deducted from the operating earnings, as a return on the investment, is all of the earnings from that property, which will be subject to tax, provided the operating earnings are accurately estimated. Assuming an accurate estimate of operating earnings, the determination of the discount rate is tantamount to a predetermination of the taxable income, to be derived from the property valued.

Regardless of what rate of return a given value will permit, out of operating earnings, investors generally will not pay more than the cost of replacement. No property can have a market valued in excess of its replacement value. If the value as determined by an analytic appraisal, exceeds the replacement value, the discount rate assumed is inadaquate.

Nobody can be said to make an investment expecting it to be unprofitable.

All investors can not be said to expect to make as much as the most successful, but when an investor buys a property, for the purpose of exploiting it for profit, he may be safely assumed to expect to realize at least the average rate of profit, earned by the successful investors, making similar investments.

When the cost of a property near the basic date is known, and the anticipated profits could have been estimated with reasonable accuracy, when the property was purchased, the rate of profit, actually earned, is the best evidence of the rate of profit, required to bring the price, for which the property was purchased.

Where the actual cost, near the basic date, can not be ascertained, in any particular case, the actual rate of return in a similar business, involving similar risks, in which the actual investment can be determined, is the only basis upon which sound discount rates can be intelligently determined.

INADEQUATE DISCOUNT FACTORS ILLUSTRATIVE CASES

The following cases illustrate how the use of inadequate discount factors, in analytic appraisals, has resulted in the allowance of excessive values for depletion and invested capital purposes.

PENN SAND AND GRAVEL COMPANY

(1397)

This company paid $54,954.36, cash, for a deposit of sand and gravel. A discovery value of $150,297.07 was allowed. The existence of the sand and gravel was known when the property was purchased. The company was organized for the sole purpose of operating this very property as a sand and gravel pit.

The valuation allowed, for depletion purposes, was predicated upon estimated profits of $796,600, recoverable in 21 years. These profits were discounted at 8 per cent and 4 per cent, to a present value of $255,297.07, from which was deducted $105,000 to cover the cost of the plant, leaving $150,297.07 as the value of the deposit. If the taxpayer actually expected to recover, in 21 years, operating profits of $796,600, from property, which could be and was actually purchased for $54,954.36, it expected to recover the $54,954.36 invested, and a return thereon of 14 per cent and 4 per cent per year.

There was no occasion for any appraisal in this case, but the comparison of the actual cost of the property, with the value allowed, show the ridiculousness of the discount rate used in making the valuation.

TEMPLE COAL CO.

(3785)

The mining property of this company was acquired on June 24, 1914, at public auction, by the promoter of the company for $5,609-423.33, cash. This cash bid was based upon, and exactly equaled the value, which had been placed upon the property by an engineer employed by the vendor.

On July 1, 1914, seven days after its purchase for cash, this property was turned over to the taxpayer in exchange for capital stock.

The value allowed upon this property, for invested capital purposes, as of July 1, 1914, was $10,443,678.29. This value was arrived at by an analytic appraisal. Thus, this property is determined to have an actual cash value, of more than twice what was actually paid for it, in cash, exactly seven days prior to the date, as of which it is valued.

As an illustration of the appraisal methods employed by Income Tax Unit engineers in this case, the following is quoted from the report of Mr. Hugh Archbald, engineer for the committee:

> For instance, in determining the value of the culm (fine sizes of coal considered waste in earlier years) the engineer assumed that if the culm was all in one place (which it was not, being in five) then it could be prepared in a washery costing so much (instead of five washeries costing nearly five

times as much) and therefore would have the value of one culm bank. Moreover as the company could prepare the culm in the coal breakers along with fresh mined coal and therefore avoid the cost of building washeries, the estimated cost of a washery should be added to the paid-in surplus, because the company would not have to invest this money and therefore the property was more valuable and invested capital should be increased by the amount which the company would have had to invest if the culm was all in one place (which it was not) and if the company built a washery (which it did not need).

United States Graphite Co.

(1348)

This case, some features of which have already been discussed, presents a most peculiar absurdity in discounting prospective profits to ascertain the present value of property.

The property involved is a graphite mine in Mexico. Two valuations were made. One valuation was for invested capital purposes, and was as of 1893. In making this valuation the expected profit, from 1893 to 1913, is discounted at the rate of 20 per cent per annum, and a value of the graphite mined from 1893 to 1913 is determined to be $2.41 per ton. The second valuation is for depletion purposes and is of March 1, 1913. The expected profits subsequent to March 1, 1913, are discounted, at the rate of 10 per cent per annum, and the value of the graphite mined subsequent to March 1, 1913, is fixed at $11.14 per ton, for depletion purposes.

The principal element to be considered in the selection of a discount rate is the matter of risk involved in recovering the expected profit. In 1893, as of which date the 20 per cent rate is applied, Mexico had a stable government, under which foreign capital was being encouraged to invest in Mexico. In 1913, as of which date, the discount rate is 10 per cent, Mexico was in a state of revolution.

Diaz was overthrown in 1910. In 1913 Madero had come and gone, and Huerta was just coming into power. The most prominent subject of revolutionary propaganda was the exploitation of the natural resources of Mexico by foreign capital. This propaganda finally resulted in the constitution of 1918, which denounced the title to all mineral lands held by foreigners. The title to this very property, upon which a 1913 value of $1,043,044.56 was fixed by the Income Tax Unit, had been denounced long before that valuation was made.

Thus, in 1923, the Income Tax Unit holds, in this case, that in 1893, when the titles of foreign owners to Mexican mineral property are apparently secure, capital will demand a prospective return of 20 per cent per annum, but in 1913, when the country is in the throes of a revolution over this very question, foreign investors will invest over a million dollars, expecting no more than a 10 per cent return, a rate which is expected in the most conservative manufacturing business located under the protection of our own flag.

The fact that this very taxpayer was able, in 1918, to purchase for $37,000 a graphite deposit, 27 miles nearer the railroad, and so superior to the mine valued at over $1,000,000 that the latter mine was abandoned, shows the rate of return demanded by American capital when making Mexican investments was actually several hundred per cent.

This property was acquired in 1893 in exchange for stock of the taxpayer of the par value of $35,000. The value allowed for invested capital purposes for 1917 was $335,000, or $300,000 in excess of the par value of the stock, notwithstanding the provision of section 207 of the 1917 act limiting such value to the par value of the stock.

This taxpayer was allowed depletion in 1918 and 1919, although the title to this property had been lost by this company and acquired by a Mexican corporation in 1918. This allowance was made upon the ground that its depletion is spread over the product as sold, and not over the product mined, and that the taxpayer had two years' supply on hand at its factory in Saginaw, Mich., to be depleted in 1918 and 1919.

In the Celite Products case, which follows, the depletion allowances were based upon the product mined. The application of the rule followed in the Celite Products case to this case would entirely bar depletion in this case for 1918 and 1919, while the application of the rule followed in this case would materially reduce the depletion allowance in the Celite Products case. There appears to be no consistent principle except to follow the method which will give the taxpayer the greater deduction.

BORDER ISLAND CO.

(1434)

This taxpayer claimed depletion upon the March 1, 1913, value of its lessor interest in an island, consisting of a deposit of sand and gravel.

The affidavit of the president of the taxpayer, filed with the Income Tax Unit in support of its claim, states "that said island was purchased by said company on or about June 15, 1912, at and for the sum of $130,000" (1469), and "that the value of said island in 1913 was about the same as 1912" (1470).

This property was acquired by the taxpayer subject to a lease, providing for the removal of the entire deposit, at a fixed royalty, with provision for minimum payments.

The value of this island for invested capital purposes was fixed by the nonmetals valuation section at $130,000, as of date of acquisition.

A part of the island was not removable as sand and gravel; and the value of the removable deposit, as of date of acquisition, was fixed by the nonmetals valuation section at $127,000. The amount of sand and gravel removable was estimated at 4,694,764 cubic yards, and the unit of depletion was determined to be 2.7 cents per cubic yard. Deducting the value of the gravel removed between June 15, 1912, and March 1, 1913, at the rate of 2.7 cents per cubic yard, left a March 1, 1913 value of $121,082.25, to be depleted at the rate of 2.7 cents per cubic yard (1476).

The valuation of $130,000, as of June 15, 1912, for invested capital purposes was accepted by the taxpayer, but a protest was filed as to the valuation of $121,082.25, as of March 1, 1913, for depletion purposes, and the case was reviewed by the solicitor's office. An oral hearing was given the taxpayer, but the nonmetals section was neither heard nor notified of the hearing. The solicitor's office made a valuation, by an analytic appraisal, of $196,159.99 as of March 1, 1913, which resulted in a depletion unit of 4.42 cents per cubic yard (1496). This valuation was based upon an estimate of expected profits of $306,499.98, to be realized in 13 years, discounted at a 6 per cent profit rate and a 4 per cent sinking fund rate.

This case furnishes an excellent illustration of the difference between the rate of profit actually expected by the investor, and the rate of profit assumed to have been expected in making this appraisal.

The fact that there could be no increase in the value per cubic yard of this deposit to the taxpayer during the eight and one-half months which elapsed between the date of its purchase by the taxpayer for $130,000, and the date as of which value for depletion purposes is fixed, is shown not only by the statement of the president of the taxpayer's company, above quoted, but also by the circumstances of the case.

This property was purchased subject to a lease, providing for the removal of the deposit at a fixed royalty and the expected receipt of royalty under this lease was the basis of the analytical appraisal. Had this gravel doubled in value between June 15, 1912 and March 1, 1913, the taxpayer would not have profited a cent by the increase in value. All of the benefit of any increase in the value of the gravel would go to the lessee. If, however, the gravel had been carried away by the current, or stolen, or if the lessee had failed to pay for the gravel taken under the lease, the taxpayer would be the loser.

Thus, the expected profits under the lease were the maximum, but not the minimum of what the taxpayer might realize out of the property. As this property was acquired subject to the lease, which limited the profits, the maximum expected profit of $306,499.98 after March 1, 1913 was as definitely ascertainable on June 15, 1912 as on March 1, 1913.

The purchase of this property on June 15, 1912, was a transaction voluntarily entered into between a willing buyer and a willing seller. The price paid fixed the fair market value at that date. Using expected profits as a basis of value, this actual transaction showed that the seller was willing to take $130,000 for the expected profits, to be realized after June 15, 1912, which is the equivalent of $121,082.25 for the expected profits to be realized after March 1, 1913. It must be assumed that with the profit limited by the lease, the buyer expected the rate of profit, which the fixed royalties would pay on the purchase price, after returning the investment. This actual transaction proves that the seller was willing to take and the buyer willing to pay $121,082.25 for $306,499.98 of profit, to be realized in 13 years, or a return of 13½ per cent per annum on the purchase price. In spite of the fact that the Solicitor's office had before it the unalterable data showing that this buyer was expecting a rate of return of 13½ per cent, it valued this property upon the assumption that the buyer expected only a 6 per cent return, and the property therefore had a value of $196,159.99.

Celite Products Co.

(See supplement)

This taxpayer acquired a deposit of diatomaceous earth, used for filter and insulation purposes, in February, 1912, for $325,000, par value of its capital stock. At this time the company had done no business, earned no profits, and its stock had no market value, except such as would be attributable to the property acquired.

A value for invested capital purposes, as of date of acquisition (February, 1912), was allowed at $325,000. A value for depletion purposes, as of March 1, 1913, was allowed at $1,550,000. This action was taken by Mr. C. C. Griggs, assistant head of the engineering division, over the protest of Mr. J. H. Briggs, valuation engineer.

The value for depletion purposes of $1,550,000 was based upon estimated annual production of 70,000 tons, although the total tonnage mined in 1912, which is the only data prior to 1913, was 3,054 tons. The total mined from 1912 to 1919, inclusive, was 193,606 tons, or an average of only 24,201. Thus, it was estimated, that the tonnage to be mined would be 23 times what was shown by past experience.

It was estimated that a profit of $2 per ton would be earned on 70,000 tons per year. There is no data in the record substantiating this estimate of profit per ton, as practically no profit was earned until 1917.

Estimating expected profits at $140,000 per year, on the assumption that production would be multiplied 23 times over past experience, and assuming a profit of $2 per ton, when past experience showed none, it was assumed that 8 per cent would cover the risk of these estimated profits not being fully realized, and a return upon the capital invested. That there was a real risk involved, in the realization of the amount of profit estimated, is shown by the fact, that no profit was in fact realized until 1917, and the operations of several years resulted in losses.

The taxpayer, in its 1918 return, estimated that the stock exchanged for this property was worth 37 per cent of par. This would give the property a value of $120,025, as of date of acquisition. Nothing happened between the date of acquisition, February, 1912, and March 1, 1913, which would effect the value, except the making of some contracts for the sale of products, the performance of which resulted in losses. Instead of increasing the value of the raw material, these contracts would destroy what value was attributed to the materials used, if value is based on prospective profits. But leaving these losses out of consideration, the March 1, 1913, value, based on the value fixed by the taxpayer, on the stock given for the property, would be less than the value of the property acquired, by the value of the materials used in 1912. The tonnage acquired was estimated at 1,750,000 tons. Assuming the value of 1,750,000 tons, as 37 per cent of the par value of the stock, or $120,025, the value per ton is 6.8586 cents per ton, as a depletion unit, instead of 88.6 cents allowed by the Income Tax Unit.

The tons mined, the depletion properly allowable at 6.8586 cents, and the depletion allowed at 88.6 cents, for the years 1917 to 1920, inclusive, are as follows:

Year	Tons mined	Depletable property allowable	Depletion allowed as deductions from income
1917	35,127	$2,409.22	$31,122.52
1918	50,628	3,472.37	44,856.41
1919	56,485	3,874.08	50,015.71
1920	68,553	4,701.78	60,737.96

The Income Tax Unit estimated the expected profits at $140,000 per year for 40 years, or $5,600,000, and reached its value of $1,550,000 as of March 1, 1913, by discounting at 8 and 4 per cent. To bring this kind of an estimate of profits to the value given by the taxpayer as the value of the stock given in exchange for the property would require a discount rate of 115 and 4 per cent.

This is another case which emphasizes the fact that in determining proper discount rates to be applied to the estimates of expected profits accepted by the Income Tax Unit the gross inflation of the estimates of profits must be considered, and if normal discount rates based on average earnings in the industry are to be used, the expected profits must be estimated on a reasonable, conservative basis.

Notwithstanding the fact that the taxpayer itself returned the value of the stock exchanged for this property as being worth but 37 per cent of par, the property is given the full par value of the stock for invested capital purposes.

THE SULPHUR CASES

(3217-3261)

(Union Sulphur Co., Freeport Texas Co., Texas Gulf Sulphur Co.)

These cases involve the valuation of two sulphur properties for invested capital and depletion purposes, and of a third property for depletion purposes only. They present as many inconsistencies in valuation as there are elements to be considered.

These three properties are all located in the same neighborhood in Louisiana, near the Gulf of Mexico and the Texas border. The sulphur, in each case, is found at between 900 and 100 feet from the surface, in similar geological formations, and in each instance the same physical conditions are involved and the same process of recovery is used.

The mining process used was invented and patented by Herman Frasch, one of the organizers of the Union Sulphur Co. This process consists of forcing superheated water into the deposit, which melts the sulphur. It is then brought to the surface by pumping with compressed air.

The physical hazards incident to sulphur mining are many and serious. The statements of these taxpayers with reference to these hazards may be summarized as follows:

Even after drilling results have determined the approximate tonnage of sulphur present and have indicated something of the purity of the sulphur and the character of the geological formation, the availability of the particular deposit to the heating and pumping process can not be determined in advance of actual operations. The result is that the amount of money that will be required to bring in production is a pure gamble until actual production is realized.

The yield of a particular well depends entirely upon the condition of the sulphur bed and overlying formation at the point where it is tapped. There is great lack of uniformity in the sulphur bed itself.

Wells are lost through caving or running ground and sudden eruptions of underground water and through corrosion of well equipment.

Other conditions met with are the pollution of sulphur with oil or clay from the known deposits above it, the loss of molten sulphur through fissures and cavities in the formation, and access of such large quantities of cold underground water to the sulphur bed as to require an uneconomical amount of hot water from the steaming plant.

It is peculiarly true of sulphur deposits of the dome type that practical extraction tests can not be made with a small experimental plant on account of the large dimensions of the deposit which must be heated; and before it is known that sulphur can be extracted at a profit it is necessary to risk the investment required for a plant large enough for commercial operation.

In view of these physical hazards it is no exaggeration to say that investing in a sulphur deposit is gambling, and that the investor expects a gambler's profit in case of success.

UNION SULPHUR CO.

This was the first company to successfully exploit these sulphur deposits. The existence of the sulphur upon the property acquired by it, in 1896, had been known since 1867, when it was discovered in drilling for oil. A vast amount of money had been spent by former owners in unsuccessful attempts to recover the suplhur.

In 1896 Herman Frasch, who had invented and patented a process which it was believed would be successful, organized the Union Sulphur Co. with a capital of $200,000. The property in question was acquired, subject to a mortgage of $165,000 in exchange for $100,000 par value of the capital stock of the company. The remaining $100,000 of capital stock was issued to Frasch in exchange for his patent.

The value of the deposit, as of date of acquisition, allowed by the Income Tax Unit for invested capital purposes, was $3,000,000. Of this amount, $2,900,000 was illegally included in the invested capital for 1917. The value received for the assumed mortgage, representing borrowed capital, was not a part of invested capital. The par value of the stock issued for the property, or $100,000, fixed the maximum limit at which this property could be included in 1917 invested capital.

To include this property in the invested capital of subsequent years, at an amount in excess of the par value of the stock issued in exchange for it, the law requires that its value must be "clearly and substantially" in excess of that amount.

Up to the time this property was purchased by this company it had been an expensive failure. All of the money spent upon it had been lost. Every process which had been tried had failed. Frasch had an untried process, the trial of which involved the expenditure of several million dollars before its success or failure could be determined. The Frasch process was patented and was not available to any prospective purchaser except the owner of the patent. Under these conditions the market value of this property could not be "clearly and substantially" anything, except what the Union Sulphur Co. was willing to give for it, which was $100,000 par value of its stock. The property was absolutely valueless to anyone else.

Can this $100,000 of stock be said to have had a clear and substantial value of thirty times its par value when this property was acquired? The company had done no business, produced no sulphur, and shown no earnings. It was not known that the Frasch process was practical or that this deposit was adaptable to profitable exploitation by the process, and it would require the expenditure of several million dollars to find out.

The value of $3,000,000 placed on this property as of date of acquisition is a clear reflection of the increment in value, after acquisition, due to the success of the business. As has been shown, the Supreme Court of the United States had held that such increment can not be included in invested capital.

For depletion purposes the deposit of the Union Sulphur Co. was valued at $16,838,423 as of March 1, 1913. This value resulted in a depletion unit of $2.80 per ton. This value was determined by discounting the estimated expected operating profits for 20 years at the rate of 15 per cent per annum. The 15 per cent flat rates of discount applied in this valuation to a 20-year life is equivalent to a rate of 16⅚ per cent and 4 per cent applied through Hoskold's sinking-fund table.

FREEPORT SULPHUR CO.

This company acquired its sulphur property in July, 1912, for $450,000 cash and subsequent payments of $1.75 per ton for the first 200,000 tons of sulphur mined and 75 cents per ton for the additional sulphur mined.

The solicitor ruled that the subsequent payments, based upon tonnage mined, are deferred payments of the purchase price and are not royalties The Income Tax Unit allowed a value as of date of acquisition and as of March 1, 1913, of $13,375,857 for both invested capital and depletion purposes. The unit of depletion on this value is $3.86 per ton.

The only investment in the property on the date of acquisition was the $450,000 paid therefor. It is immaterial whether the subsequent tonnage payments are considered royalties or deferred payments on the purchase of the fee. The taxpayer assumed no obligation to pay any definite sum in addition to the $450,000. The taxpayer subjected no money nor credit to risk in the purchase of this property except $450,000. The obligation to make additional payments was measured by and arose only as and when sulphur was mined.

The only difference between this sale of a fee for a fixed sum and tonnage payments and the sale of a mining lease for a bonus and royalties is that in this case the property containing the deposit will belong to the taxpayer after the deposit is exhausted, while in the case of the sale of a lease for a bonus and royalties the use of the fee reverts to the lessor on the exhaustion of the deposit. As there is no claim that this property had any value, except such as arises out of the sulphur, there is no difference between this transaction and the sale of a royalty lease for a bonus, except a difference of terminology.

The substance of the transaction is that this taxpayer paid $450,000 in July, 1912. for the privilege of buying sulphur at the rate of $1.75 per ton for the first 200,000 tons and 75 cents per ton for the balance of the sulphur to be recovered from the deposit. No obligation as to these tonnage payments arising until the sulphur is mined, these payments can not be considered invested capital in any sense. The capital invested was $450,000, and the subsequent payments are current expenses incident to the recovery and sale of the sulphur.

By allowing the same value for both invested capital purposes and depletion purposes the Income Tax Unit determined that there had been no change in the value of this deposit between the date of acquisition in July, 1912, and on March 1, 1913. In this the unit is unquestionably right, as there can be no presumption that the market value will change in eight months in the absence of a showing that such change has occurred.

Assuming, what the Income Tax Unit held, that the value of this property on the date of acquisition and on March 1, 1913, were the same, how is that value to be determined?

The property was actually sold for $450,000 cash. There is nothing in the record to indicate that this was not a transaction voluntarily entered into between a willing buyer and a willing seller. Under these conditions this actual sale for cash is the very best evidence of the market value. The Income Tax Unit has allowed a value of $13,375,851. This value was determined by discounting expected profits for 17 years at the rate of 10 per cent and 4 per cent through Hodkold's tables.

In determining this value it was assumed that the deposit would yield 3,459,000 tons of sulphur in 17 years, and that the profit would be $10 per ton. This is assuming that the taxpayer could mine and sell more than 200,000 tons of sulphur a year.

In 1913 the taxpayer's plant had a rated maximum capacity of only 120,000 tons.

This plant had hardly begun to operate in March, 1913. The total output was only 726 tons in 1912 and 10,747 tons in 1913.

But even if it was assumed that plant capacity could be increased, the ability of the taxpayer to dispose of 200,000 tons of sulphur a year was open to serious doubt.

In March, 1913, the Union Sulphur Co. had a monopoly of the sulphur business. It had operated since 1896, with no competition, and its selling and distributing organization and contact with the trade was established. The Union Sulphur Co. not only had all the business but it also had a plant capacity capable of producing twice what the market could consume. The tonnage produced and the tonnage sold by the Union Sulphur Co. from 1905 to 1913, inclusive, is as follows:

Production and sales of Union Sulphur Co.

Year	Tons mined	Tons sold	Year	Tons mined	Tons sold
1905	218,950	160,495	1910	246,510	260,369
1906	288,560	178,519	1911	304,220	252,949
1907	185,772	268,755	1912	786,605	304,260
1908	362,896	204,925	1913	478,565	318,087
1909	270,725	254,945			

It will be seen that the assumption that the Freeport Sulphur Co. would sell 200,000 tons a year must be based upon the assumption that it was going to take about 66 per cent of the business of the Union Sulphur Co. away from the latter company. While this assumption must be made to justify the estimated earnings and period of recovery used in valuing the Freeport property, yet in valuing the Union property it is assumed that its output will not be decreased.

The assumption that the Freeport Co. would take away two-thirds of the business of the company which already had that business, and the assumption that the Freeport Co. could produce 200,000 tons of sulphur with a 120,000-ton plant, certainly involved considerable speculative hazard.

There is another element of risk in the Freeport case. The Union Sulphur Co. owned the unexpired patent on the only known successful process for recovering this sulphur, and any purchaser of this property on March 1, 1913, was buying a lawsuit. That this hazard was a real one is shown by the fact that the Union Sulphur Co. immediately protested against the use of the Frasch process by the Freeport Co., and in 1915 brought an action which was not terminated until 1919. In 1918 the Freeport Co. was restrained from declaring dividends pending the determination of this suit.

Thus, in this case we have a new company, just starting, with no operating experience, facing all the physical hazards to which the Union Co. was subject, with the Union Co. in control of the patent on the process and in control of and capable of supplying the entire market; yet it is assumed that there is so much less hazard involved in recovering the prospective profits of the Freeport Co. that its estimated profits are only discounted at a 10 per cent and 4 per cent rate, while a 16⅚ per cent and 4 per cent rate is used in the Union case. The value in the ground of the Freeport sulphur is fixed at $3.86 per ton, while the value of the deposit is fixed at $2.80 per ton, both as of March 1, 1913.

This valuation shows very clearly that the demand for sulphur created by the war was taken into consideration, and that values, which no purchaser, in 1913, could have possibly anticipated, are given to the property as of March 1, 1913.

TEXAS GULF SULPHUR CO.

The valuation of the property of this taxpayer is as of March, 1919, for discovery depletion purposes. The right of this company to discovery depletion has already been discussed.

The reserves of this company are estimated at 8,000,000 tons, and the life of the property is assumed to be 12 years. The profit per ton is estimated at $9, and the discount rate is 7 per cent and 4 per cent. The value allowed for depletion purposes is $38,920,000, and the depletion unit allowed is $4.86 per ton. The property in question was purchased in 1909 for $250,000.

Discounting expected profits from a sulphur mine on a 7 per cent profit basis is putting this hazardous business on the same basis, as to safety of the investment and return of expected profit, as would be attributed to a well secured first mortgage or industrial bond in 1919. With all the nations of the world competing in the money market, with the United States appealing to its citizens to buy its bonds, with the most conservative industrial bonds being sold on a 7 per cent return basis, this new company could not have borrowed $38,920,000 at 7 per cent, and if it could have it would have carried the hazard of the business itself.

There is no possible theory imaginable upon which any purchaser would have invested in this hazardous business on the assumption that he would make only 7 per cent per annum on his money.

The application of a discount rate of 16⅚ per cent and 4 per cent to the Union Sulphur Co. in 1913 and a 7 per cent and 4 per cent rate to the Texas Gulf Co. in 1919 can be justified only upon the fallacious theory that, as between two concerns in the same business, a well established, successful concern is a more hazardous investment than a new concern with neither trade nor experience behind it.

The commissioner has filed an answer in these cases. In this answer he takes the position that if the expected profits of the Union Sulphur Co. are reduced, its estimated plant cost increased, and it is denied depletion on sulphur mined but not sold, and if the estimated plant cost of the Freeport Sulphur Co. is decreased and its estimated profits increased, and if the estimated life of the Texas Gulf Co. and its estimated profits are increased, all of these properties can be valued on a 10 per cent and 4 per cent basis and get the same results as are shown by these valuations.

It is obvious that, if the factors in any valuation are changed, any desired result may be obtained.

The commissioner's answer states that a discount rate of 10 per cent and 4 per cent was recommended in these cases by this committee. There is nothing in the record to substantiate this statement, and nothing could be further from the fact. The committee made no recommendation whatever on this subject, and the committee's staff has consistently maintained the attitude that the discount rates applied in analytical appraisals should be such as to reflect at least approximate market values.

That a 10 per cent and 4 per cent discount rate does not reflect market value is conclusively demonstrated by the Freeport Sulphur case, in which that rate was used and resulted in a value of $13,375,851, whereas the actual market value of the property, as shown by its actual sale, was but $450,000.

From the facts assumed by the unit in the Freeport case the actual rate of profit expected by investors in this business can be determined, and when the expected profits of these properties are discounted at such rate real market value will be approximately determined.

It was assumed that the Freeport property would yield 3,459,000 tons of sulphur at an operating profit of $10 per ton. Thus the total operating profits are estimated at $34,590,000. For the first 200,000 tons the taxpayer has an additional payment of $1.75 to make, which will amount to $350,000, and for the balance, or 3,259,000 tons, it must pay 75 cents per ton, or $2,444,250. The total of these two additional payments, $2,794,250, deducted from the estimated operating profits, leaves estimated operating profits of $31,795,750 after the deferred payments for the sulphur have been met. This taxpayer paid $450,000 for $31,795,750 of estimated operating profits to be recovered in an estimated period of 17 years. On the equal installment 4 per cent sinking fund basis used by the Income Tax Unit, the realization of these estimated earnings will return the $450,000 invested at the end of 17 years and an annual profit of 411 per cent. Thus if the unit's estimate of expected profit is to be accepted as the basis for determining value, it will be necessary to use a discount rate of 411 per cent, instead of 10 per cent, to get the market value shown by the actual sale of this very property.

Viewed in the light of 1913 conditions, which the law requires, the estimate of tonnage to be mined each year was beyond all reason, as has been shown. This valuation was made in 1921, when actual production during the war period was known, and is unquestionably based upon such production instead of upon 1913 conditions. This overestimate of annual production decreases the estimated life and the period of time for which the anticipated profits are discounted. This error has the effect of multiplying the inadequacy of the discount factor, and had a proper life been estimated the value determined would be reduced. Lengthening the estimated life would decrease the discount rate necessary to reduce the expected profits to the actual cash value of $450,000.

When the tremendous hazards, both physical and fiscal, the tremendous plant investment required to be made before the possibility of even knowing whether any profit can be recovered are considered, it is easy to see why so great a percentage of profit is expected from the money invested in a sulphur deposit. The fact is that without the plant and the right to use the process the deposit has no value, and the fact that existing going plants can more than supply the market adds another element of hazard.

Oil Valuations

EFFECT OF DISCOUNTING

The methods used in valuing oil properties differ from those followed in the valuation of mines and other deposits.

In making an oil-well valuation the total reserves in the ground are estimated. The price to be obtained for the oil is estimated on a per barrel basis. The cost of drilling, pumping, overhead, and all other costs are estimated and reduced to a per barrel basis. The cost per barrel is deducted from the price, giving the expected profit per barrel.

From 65 to 90 per cent of all the oil a well will produce will be produced during the first year, and half of the remainder will be produced during the second year. The production for each year until the total recoverable reserves are exhausted is estimated.

The number of barrels estimated, to be recoverable each year, are multiplied by the estimated profit per barrel. The total profits, estimated to be recoverable each year, are then valued, by separately discounting each year's expected profits, at the discount rate compounded for the period of deferred recovery. The values of each year's profits, thus obtained, are divided by the total estimated reserves to determine the depletion unit. As oil is recovered from the well during operations, the number of barrels produced during each year is multiplied by the depletion unit, to determine the amount of depletion deductible from income.

MR. GREENIDGE ON DISCOUNT RATES

During the early hearings, in March, 1924, Mr. S. M. Greenidge, head of the engineering division of the Income Tax Unit, testified before the committee that in his judgment the discount rate is a negligible factor in an analytic appraisal and that he would not discount at all (330-364). This statement is vitally important, as all valuation work came under the jurisdiction of Mr. Greenidge. As the judgment of Mr. Greenidge controlled the valuation work of the Income Tax Unit, his statements with reference to the use of discount factors in oil valuations are quoted verbatim:

Mr. GREENIDGE. I am inclined to think the ultimate reserves are the governing factors, and not the discount rates (331).

Mr. GREENIDGE. Personally, if I were called upon to make a valuation of that kind for an oil operator, I would be very much inclined to use as small a discount factor as possible, if not disregard it (334).

Senator COUZENS. You have not been able to determine whether or not any other companies were required to fix it at 5 per cent basis, have you?

Mr. GREENIDGE. No, sir. I did state, however, that some companies did not use any.

Senator COUZENS. Why was that?

Mr. GREENIDGE. Because their valuations were set up, disregarding any discount factor, were so reasonable, or so nearly within the limits of reasonableness, that a discount factor becomes an unimportant phase. In fact, as I testified at a previous hearing, I personally would not introduce a discount factor. (356).

In response to a request by the committee, Mr. Greenidge prepared four valuations, based upon two hypothetical cases in two of which he used a 5 per cent discount rate, and in the other two, 10 per cent. Mr. Greenidge contended that these valuations demonstrated the truth of his statements that the discount factor is immaterial. The valuations referred to are as follows:

Estimated ultimate recovery, 500,000 barrels oil:

Market price of oil at date of estimate	$1.25
Drilling, pumping, overhead, and all other cost	.25
Net value of oil	1.00

Present worth computed at 5 per cent compound discount for deferred receipts:

First year's production	240,000	barrels×$1×$0.9524=	$228,576
Second year's production	120,000	barrels×$1×$0.9070=	108,840
Third year's production	60,000	barrels×$1×$0.8638=	51,828
Fourth year's production	36,000	barrels×$1×$0.8227=	29,617
Fifth year's production	20,000	barrels×$1×$0.7835=	15,670
Sixth year's production	12,000	barrels×$1×$0.7462=	8,954
Seventh year's production	6,000	barrels×$1×$0.7107=	4,264
Eighth year's production	3,000	barrels×$1×$0.6768=	2,030
Ninth year's production	2,000	barrels×$1×$0.6446=	1,289
Tenth year's production	1,000	barrels×$1×$0.6139=	614
	500,000		[1] 451,682

[1] Present worth of 500,000 barrels at date of estimate.

Composite discount factor, 9.66 per cent.

Present worth of same number of barrels of oil of same net value per barrel computed at 10 per cent compound discount for deferred receipts:

First year's production	240,000 barrels×$1×$0.9091=	$218,181
Second year's production	120,000 barrels×$1×$0.8264=	99,168
Third year's production	60,000 barrels×$1×$0.7513=	45,078
Fourth year's production	36,000 barrels×$1×$0.6830=	24,588
Fifth year's production	20,000 barrels×$1×$0.6209=	12,418
Sixth year's production	12,000 barrels×$1×$0.5645=	6,774
Seventh year's production	6,000 barrels×$1×$0.5132=	3,079
Eighth year's production	3,000 barrels×$1×$0.4665=	1,400
Ninth year's production	2,000 barrels×$1×$0.4241=	848
Tenth year's production	1,000 barrels×$1×$0.3855=	386
	500,000	[1]411,919

Composite factor, 17.6 per cent

	Per barrel
Estimated ultimate recovery, 1,000,000, barrels oil.	
Market price of oil at date of estimate	$1.25
Drilling, pumping, overhead, and all other costs	.25
Net value of oil	1.00

Present worth computed at 5 per cent compound discount for deferred receipt:

First year's production	480,000 barrels×$1×$0.9524=	$457,152
Second year's production	240,000 barrels×$1×$0.9070=	217,680
Third year's production	120,000 barrels×$1×$0.8638=	103,656
Fourth year's production	72,000 barrels×$1×$0.8227=	59,234
Fifth year's production	40,000 barrels×$1×$0.7835=	31,340
Sixth year's production	24,000 barrels×$1×$0.7462=	17,909
Seventh year's production	12,000 barrels×$1×$0.7107=	8,528
Eighth year's production	6,000 barrels×$1×$0.6768=	4,061
Ninth year's production	4,000 barrels×$1×$0.6446=	2,578
Tenth year's production	2,000 barrels×$1×$0.6139=	1,228
	1,000,000	[2]905,366

Composite factor (discount), 9.66 per cent.

Present worth of same number of barrels of oil of same net value per barrel computed at 10 per cent compound discount for deferred receipts:

First year's production	480,000 barrels×$1×$0.9091=	$436,368
Second year's production	240,000 barrels×$1×$0.8264=	198,336
Third year's production	120,000 barrels×$1×$0.7513=	90,156
Fourth year's production	72,000 barrels×$1×$0.6830=	49,176
Fifth year's production	40,000 barrels×$1×$0.6209=	24,836
Sixth year's production	24,000 barrels×$1×$0.5645=	13,548
Seventh year's production	12,000 barrels×$1×$0.5132=	6,158
Eighth year's production	6,000 barrels×$1×$0.4665=	2,799
Ninth year's production	4,000 barrels×$1×$0.4241=	1,696
Tenth year's production	2,000 barrels×$1×$0.3855=	771
	1,000,000	[2]823,844

Composite discount factor, 17.6 per cent.

The most favorable test of any method is to assume that it has been correctly applied. Let us assume, that in making these hypothetical valuations, Mr. Greenidge has properly predicted the price, expense, and rate of recovery of oil.

[1] Present worth of 500,000 barrels at date of estimate.
[2] Present worth of 1,000,000 barrels at date of estimate.

In the first case the ultimate recoverable reserves are assumed to be 500,000 barrels. He has estimated, in the case of the first well, that the net operating profit will be $500,000, and using a 5 per cent discount rate he gets a value to be depleted of $451,682. Thus discounting at 5 per cent, $451,682 of the operating profits will be deducted as tax free depletion, and the taxable income from this property will be $48,318.

Using a 10 per cent discount factor of this same property, Mr. Greenidge gets a value of $411,919, to be returned as tax free depletion, and the balance of the $500,000 estimated operating profits, or $88.081, is taxable income.

Thus discounting at 10 per cent instead of 5 per cent, increases the taxable income 81.4 per cent.

In the case of the second property, the ultimate recoverable reserves were assumed to be 1,000,000 barrels of oil. Mr. Greenidge has estimated the operating profits to be $1,000,000. Using a 5 per cent discount rate, he gets a value of $903,366, and using a 10 per cent discount rate, he gets a value of $823,844. Deducting these respective values from $1,000,000, we find, that, if his estimates of operating profits are correct, the taxable income, in case the discount rate is 5 per cent, is $96,634, and if a 10 per cent discount rate is used, taxable income is $176,156, or an increase in taxable income of 82.3 per cent.

Thus, by simple arithmetic, we prove that an increase in the discount factor will produce a constant decrease in valuation and increase in taxable income.

If we now use Mr. Greenidge's own figures to compute depletion, it will be equally simple to prove that the ultimate recoverable reserves, which Mr. Greenidge stated are the one thing he would consider, have no effect whatever upon the depletion unit.

The depletion unit is determined by dividing the value by the number of units in the recoverable reserves. As the operating earnings were determined by multiplying the profit per unit by the number of units in the recoverable reserves, the division of the discounted value of the operating profits by the number of units in the reserves eliminates the reserves and the depletion unit is the discounted value of the operating profit per unit.

Mr. Greenidge's figures are used as the basis of the calculations:

A 500,000-barrel well, operating profit $1 per barrel, discounted at 5 per cent.

Value $451,682, divided by total operating profits, $500,000, equal depletion unit, 90.3 cents per barrel.

A 1,000,000-barrel well, operating profits $1 per barrel, discounted at 5 per cent.

Value $903,366, divided by total operating profits $1,000,000, equal depletion unit 90.3.

It will be noted that the depletion unit does not vary with the estimated reserves, but that the same depletion unit is obtained for a 500,000-barrel well as for a 1,000,000-barrel well.

So long as the variation in annual production is constant, the value per barrel, or the depletion unit, will be a fixed percentage of the expected profit per barrel, which percentage is fixed by the discount rate regardless of the estimated reserves.

That the depletion unit will vary with the discount factor can be proven by comparing Mr. Greenidge's appraisal of these same two wells, using a 10 per cent discount rate.

A 500,000-barrel well, operating profit $1 per barrel, discounted at 10 per cent, total operating profit $500,000, divided by value $411,919, equals depletion unit 82.4 per barrel.

A 1,000,000-barrel well, operating profit $1 per barrel, discounted at 10 per cent, total operating profit $1,000,000, divided by value $823,844, equals depletion unit 82.4 per barrel.

The use of a 10 per cent discount rate thus gives a depletion unit of 82.4 cents per barrel, instead of 90.3 cents, produced by discounting at 5 per cent.

The depletion unit, multiplied by the number of barrels produced, determines the tax-free deduction for depletion. Only the profit per barrel in excess of the depletion unit is taxable. Mr. Greenidge estimated the profit at $1 per barrel in these cases. If that estimate is correct, the taxable profit will be 9.7 cents if a 5 per cent discount rate is used, or 17.6 cents in case a 10 per cent discount rate is used.

Regardless of what the profit may be, the taxable inome will always be 9.7 per cent of the estimated profit per barrel, when a 5 per cent discount factor is used, and 17.6 per cent of the estimated profit per barrel, when a 10 per cent discount factor is used, assuming the life of the property to be 10 years, which was assumed in these cases.

Mr. Greenidge says that "I, personally, would not introduce a discount factor."

If estimated profits are not discounted, the depletable value equals the estimated profit, and there will be no taxable income from the property, unless the actual income exceeds the estimated income.

Assume that the reserves in the 500,000 barrel well had been underestimated 100,000 barrels, and the well produces the estimated total production of 500,000 in the first three years of its life, and the remaining 100,000 barrels in the last 7 years of its life. Assume that because of his ability to look into the future and predetermine that the estimated production is 100,000 barrels short of actual production, Mr. Greenidge does not discount. The value will be $500.000 and the depletion unit $1 per barrel. During the first three years the well produces 500,000 barrels, which produces a profit of $500,000, all of which is exempt from tax.

During the last seven years, the well produces 100.000 barrels, upon which no depletion is allowed. because the full value has been depleted upon the production of the first three years. This excess production produces $100,000 of taxable income during the last seven years.

Let us assume that the first three years were 1919, 1920, and 1921, when the tax rate applicable to the operator would have been 40 per cent, and the last seven years are 1922, to 1928 with a tax rate of 12½ per cent. Thus, by underestimating the reserves 20 per cent, the taxpayer pays a tax on $100,000 of income, at 12½ per cent, or a tax of $12,500.

Assume now that the reserves had been estimated at 600,000 barrels. At $1.00 per barrel, the profits are estimated at $600,000. These profits are discounted at 10 per cent, which leaves 17.6 per cent of the profits subject to tax. During the first three years $500,000 of profits are recovered, 17.6 per cent, or $88,081, of which is taxable at 40 per cent. The tax is $35,232.40. The balance of the taxable income, or $100,000, is recovered during the last seven years, and, of this, $17,600 is taxable at 12½ per cent. The tax is $2,200. The total tax on this basis is $37,432.40.

Thus, when the property is undervalued $100,000, by reason of an underestimate of reserves, and because of the undervaluation, there is no discount, but the taxpayer is deprived of depletion on 100,000 barrels of oil, he pays a tax of $12,500. On the other hand, with a full estimate of reserves, and a value on every barrel of oil, and depletion on every barrel produced, but a discount of 10 per cent, the taxpayer pays a tax of $37,432.40.

The conclusion is inevitable, that either Mr. Greenidge deliberately attempted to mislead this committee, or is hopelessly ignorant of the work over which he has had jurisdiction.

MID-YEAR DISCOUNTING IN OIL VALUATION

It is the practice of the oil and gas valuation section to discount the expected earnings of each year from the middle instead of from the end of the year (1901). This practice assumes that an oil-well operator has reduced to possession on June 30 and has reinvested all of the profits he will realize to and including the following December 31. No other property is valued on this basis.

The effect of this practice is to reduce the amount discounted from the first year's earnings by one-half and to discount all subsequent earnings for six months less than the period required for their realization. It is a noteworthy fact that in making the hypothetical valuations requested by the committee Mr. Greenidge did not follow the standard practice in force in the oil and gas valuation section of his division, but discounted to the end of the year. These hypothetical valuations, therefore, do not reflect the practice of the Income Tax Unit, and the valuations shown are less than would be given had the standard practice been followed.

The following tables show the factors which represent the value at beginning of the first year of $1 recoverable in the year designated, the valuation of each year's earnings of the 500,000-barrel well, discounted at 5 per cent and at 10 per cent, compounded from the end of the year, as computed by Mr. Greenidge, and the value of the same earnings, discounted at 10 per cent, compounded from the middle of the year, in accordance with the standard practice of the oil and gas valuation section.

These tables also show the net taxable income from the property upon each basis of discounting, assuming the accuracy of Mr. Greenidge's estimate and distribution of profits.

VALUATION FACTORS

The figures shown below represent the value at the beginning of the first year of $1 of operating profits, recoverable during each year designated in the first column, at the discount rates designated in the heading:

Value, at the beginning of first year, of $1 of operating profits, recoverable during year designated in first column, when discounted at annual rates shown in headings, compounded

Year	5 per cent from end of year	10 per cent from end of year	10 per cent from middle of year	Year	5 per cent from end of year	10 per cent from end of year	10 per cent from middle of year
First	0.9524	0.9091	0.95346	Sixth	0.7462	0.5645	0.59202
Second	.9070	.8264	.86678	Seventh	.7107	.5132	.53820
Third	.8638	.7513	.78798	Eighth	.6768	.4665	.48927
Fourth	.8227	.6830	.71635	Ninth	.6446	.4241	.44479
Fifth	.7835	.6209	.65123	Tenth	.6139	.3855	.40435

VALUATIONS

When the operating profits, shown in the second column of the following table, are multiplied by the valuation factors, shown in the foregoing table, the value of each year's profits at the beginning of the first year is shown by the following table:

Year	Operating profits	Value at beginning of first year of operating profits, discounted at 5 per cent from end of year in which realized	Value at beginning of first year of operating profits, discounted at 10 per cent from end of year in which realized	Value at beginning of first year of operating profits, discounted at 10 per cent from middle of year in which realized
First	$240,000	$228,576	$218,184	$228,830
Second	120,000	108,840	99,168	104,014
Third	60,000	51,828	45,078	47,279
Fourth	36,000	29,617	24,588	25,789
Fifth	20,000	15,670	12,418	13,025
Sixth	12,000	8,954	6,774	7,104
Seventh	6,000	4,264	3,079	3,229
Eighth	3,000	2,030	1,400	1,468
Ninth	2,000	1,289	848	890
Tenth	1,000	614	386	404
Total	500,000	451,682	411,919	432,032
Composite discount factor (per cent)		9.66	17.6	13.59
Depletion unit (cents)		90.3	82.4	86.4

The composite discount factors shown above are the weighted average per cent of discount of all the operating profits for the entire period of deferred recovery. This composite factor is determined by dividing the total of the present values of all the profits by the total operating profit.

The totals of the discounted values of the annual profits equal the present value of the property or the amount to be depleted.

The depletion unit is obtained by dividing the total present value by the estimated total production or 500,000 barrels.

DEPLETION DEDUCTIONS

In the following table we have assumed that the actual annual production will equal production as estimated by Mr. Greenidge. The deductions from income are determined by multiplying the actual production of each year by the depletion unit as shown by the preceding table.

Year	Production	Depletion at 5 per cent from end of year (unit 90.3 cents)	Depletion at 10 per cent from end of year (unit 82.4 cents)	Depletion at 10 per cent from middle of year (unit 86.4 cents)
	Barrels			
First	240,000	$216,720	$197,760	$207,360
Second	120,000	108,360	98,880	103,680
Third	60,000	54,180	49,440	51,840
Fourth	36,000	32,508	29,664	31,104
Fifth	20,000	18,060	16,480	17,280
Sixth	12,000	10,836	9,880	10,368
Seventh	6,000	5,418	4,944	5,184
Eighth	3,000	2,709	2,472	2,592
Ninth	2,000	1,806	1,648	1,728
Tenth	1,000	903	824	864
Total	500,000	451,500	412,000	432,000

NET TAXABLE INCOME AFTER DEDUCTING DEPLETION

In computing the net taxable income of each year we have assumed the operating profits of each year to be as estimated by Mr. Greenidge, and have deducted the depletion allowances shown in the preceding table from such operating profits.

Year	Income with depletion based on 5 per cent from end of year	Income with depletion based on 10 per cent from end of year	Income with depletion based on 10 per cent from middle of year
First	$23,280	$42,240	$32,640
Second	11,640	21,120	16,320
Third	5,820	10,560	8,160
Fourth	3,492	6,336	4,896
Fifth	1,940	3,520	2,720
Sixth	1,164	2,112	1,632
Seventh	582	1,056	816
Eighth	291	528	408
Ninth	194	352	272
Tenth	97	176	136
	48,500	88,000	68,000

It will be noted that the valuations, depletion deductions, and net taxable income dervied by discounting the operating profits in this case at 10 per cent compounded from the middle of the year are within a few dollars of being equal to the average of the valuations, depletion deductions, and net taxable income computed on a 5 per cent and on a 10 per cent basis.

The value given to the first year's profits by discounting from the middle of the year at 10 per cent is the same as will be given by discounting to the end of the year at 5 per cent. In this case 48 per cent of the profits are allocated to the first year. As the first year's profits frequently run as high as 75 per cent, and in the Gulf Oil Co. case were estimated at 95 per cent, of all the profits from an oil well, it may be safely assumed that any discount rate compounded from the middle of the year will not exceed 75 per cent of that rate compounded from the end of the year, and is more likely to be about 66 per cent of the same rate compounded from the end of the year.

In considering the discount rates actually used by the oil and gas valuation section in making the oil valuations, a discount rate designated as being 5 per cent must be interpreted as actually representing an annual return on capital of from 3.3 per cent to 3.75 per cent, and a rate designated as 10 per cent must be given a value of from 6.5 per cent to 7.5 per cent.

EFFECT OF DRILLING PROGRAM ON DISCOUNTING ANTICIPATED PROFITS TO PRESENT VALUE

An excessive valuation may be secured on an oil property by merely juggling the drilling program of the operator.

As has been shown, in valuing an oil well for depletion purposes a value is placed not only on that particular well and the oil to be recovered from that well but upon all of the oil estimated to be recoverable from the property of the taxpayer within the 160-acre area proven by the well in question. As it may require 30 additional wells to recover all of the oil to be valued, the allocation of prospective profits to future years for the purpose of discounting depends upon the time when the later wells are drilled.

About 65 per cent of the total product of one well will be produced during the first year and about 20 per cent during the second year. It may require 10 years to recover the balance. If all of the wells required to recover the reserves under the whole area were drilled at once, about 65 per cent of the entire reserves would be recovered during the first year and about 20 per cent during the second year. Under the bureau practice of discounting from the middle of the year, the first year estimated production is only discounted by one-half of the discount rate, and the amount discounted increases with each year of deferred recovery, due to the longer period over which the discount rate is applied. It therefore follows that if the profits are estimated to be recoverable earlier than they they are actually recovered an excessive valuation will be obtained.

The discounting interval between the basic date and the date of the recovery of the profits from wells not drilled on the basic date depends upon how long this drilling is deferred. In claiming a discovery valuation, the taxpayer sets up what is called a drilling program, which becomes the basis for allocating the deferred operating profits to estimated years of recovery.

How this drilling program may be manipulated to obtain an excessive valuation is shown by the case of the American Petroleum Co. of California.

AMERICAN PETROLEUM CO. OF CALIFORNIA

This case involved a March 1, 1913, value of four leases. The case was acted upon on November 7, 1923. The manner of handling one of these leases illustrates the basis of the whole valuation.

On March 1, 1913, the date as of which the value was determined, there were 19 producing wells on this lease and 4 more were in process of drilling. The taxpayer estimated that as of March 1, 1913, it will require 26 additional wells to recover the total reserves, and that such additional wells will be put in at the rate of six per year. The drilling program was thus estimated to bring in with 49 producing wells by 1917. The estimated recovery of oil was based upon this program.

When this case was acted upon the records of the Income Tax Unit show that they then knew from information furnished by the taxpayer that instead of having 49 producing wells in 1917 it had only 29 producing wells by the end of 1922. The March 1 value in this case was based upon the estimated production of 49 wells, all of which would be producing within four years of the basic date, when it was known that only 29 wells were producing by the end of nine years.

This allowance was based upon the theory that the taxpayer claimed that in 1913 it intended to complete its drilling program with 49 wells by the end of 1917, and that, inasmuch as the taxpayer could have done so, its allowance of value should be based upon its intentions rather than its actions.

By referring to the table of valuation factors shown on page 76 it will be seen that at 10 per cent applied to the middle of the year $1 recoverable during the first year has a value of 95 cents plus, while $1 recoverable during the tenth year has a value of only 40 cents plus. Thus every dollar of operating profits which is recovered in the tenth year, but which in valuing was estimated to be recoverable in the first year, was estimated to be worth more than double its value. In the case mentioned, the valuation was increased $142,-073.58, or about 10 per cent, by this juggling of the drilling program. If the depletion allowance was 50 per cent of the operating profits of any year, this 10 per cent excess of depletion would make a difference of 20 per cent in the taxable income.

HAZARDS TO BE COVERED BY DISCOUNTING IN OIL VALUATIONS

In making any appraisal for any purpose, the result sought is the amount a purchaser can ordinarily be expected to pay for the property.

When a valuation is based upon estimated expected operating profits and the recovery of such expected profits involves speculative hazards, it must be assumed that the purchaser will first discount such expected profits to the point where the hazard can be said to be eliminated, and the remaining profit can be recovered with as reasonable a degree of certainty as is afforded by a high-class bond or a first mortgage on real estate.

The proof of this proposition is found in the fact that the greater the hazard involved in any business the higher must be its dividends to permit its stock to bring par on the market.

Reducing the expected profits to this point may be said to be discounting for hazard. Unless this is done, there is nothing to induce an investor to assume the risks incident to a hazardous undertaking when he can invest his money in bonds and mortgages. To discount for hazard, it is necessary to include in the expected rate of return upon the investment a sufficient amount to cover the hazard in addition to the return which can be expected upon well-secured bonds and mortgages.

We have demonstrated that, inasmuch as the depletion unit is the discounted value of the expected profit per barrel of oil, an overestimate of profit per barrel is not offset by decreasing the total value through an underestimate of reserves. This is due to the fact that an increase in the discount rate decreases both the depletion unit and the total value to be depleted, while an increase in the reserves merely increases the total value but does not affect the depletion unit. It therefore follows that in making an appraisal for depletion purposes hazards which affect the estimated profit per barrel are not provided for by reducing the estimated reserves. Hazards which affect only the amount of oil recovered may be provided for by either reducing the estimate of probable reserves or by increasing the discount.

The great bulk of the oil valuations upon which depletion is still to be allowed are discovery valuations, which the law provides shall reflect the value on the date of discovery or within 30 days thereafter.

Some of the hazards assumed by the purchaser of a tract or lease of land within 30 days after the discovery of oil thereon may be enumerated as follows:

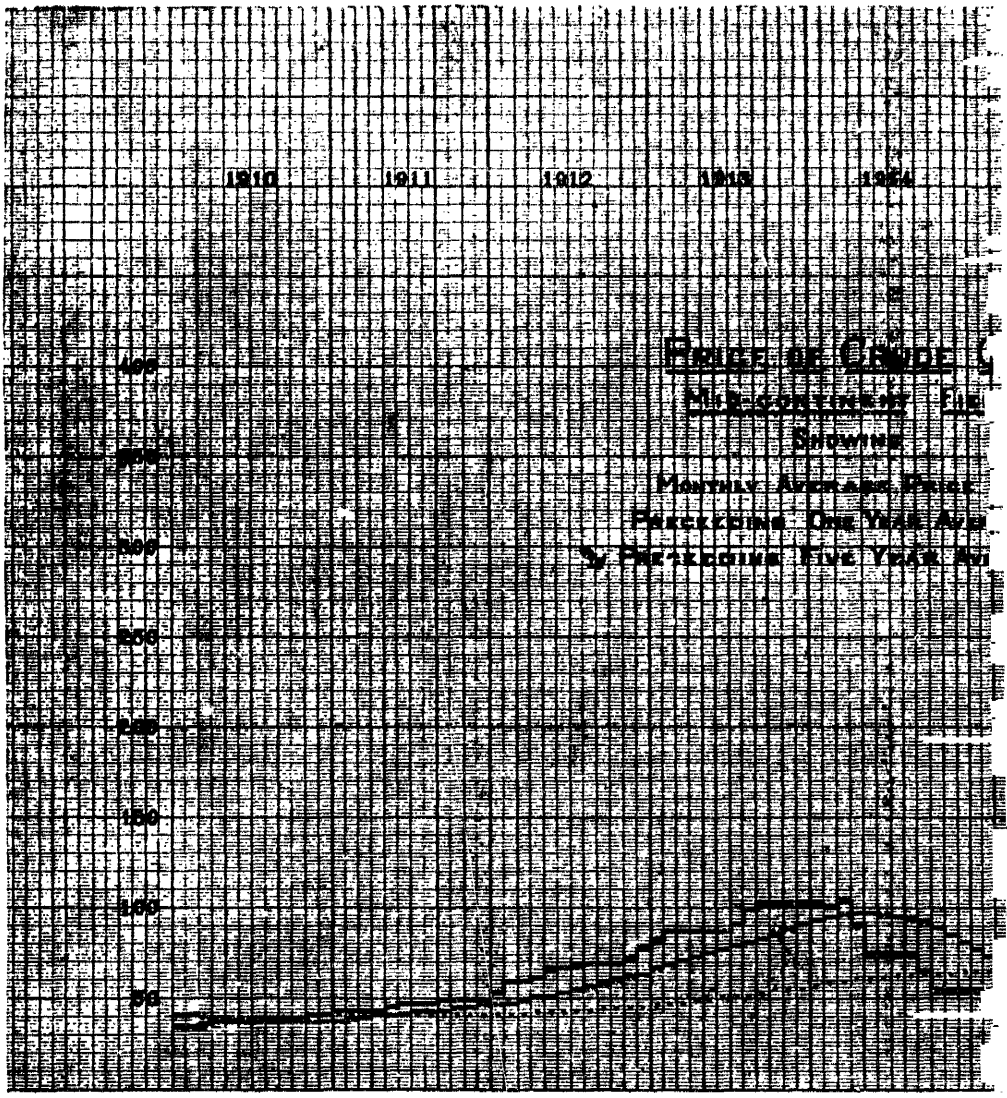
1. Decrease in expected price of oil.
2. Increase in expected cost of drilling, pumping, and equipment.
3. Fire risk.
4. Dry hole or drilling of unproductive wells.
5. Water encroachment.
6. Bleeding by neighboring wells.
7. Casing erosion.
8. Overestimated production.

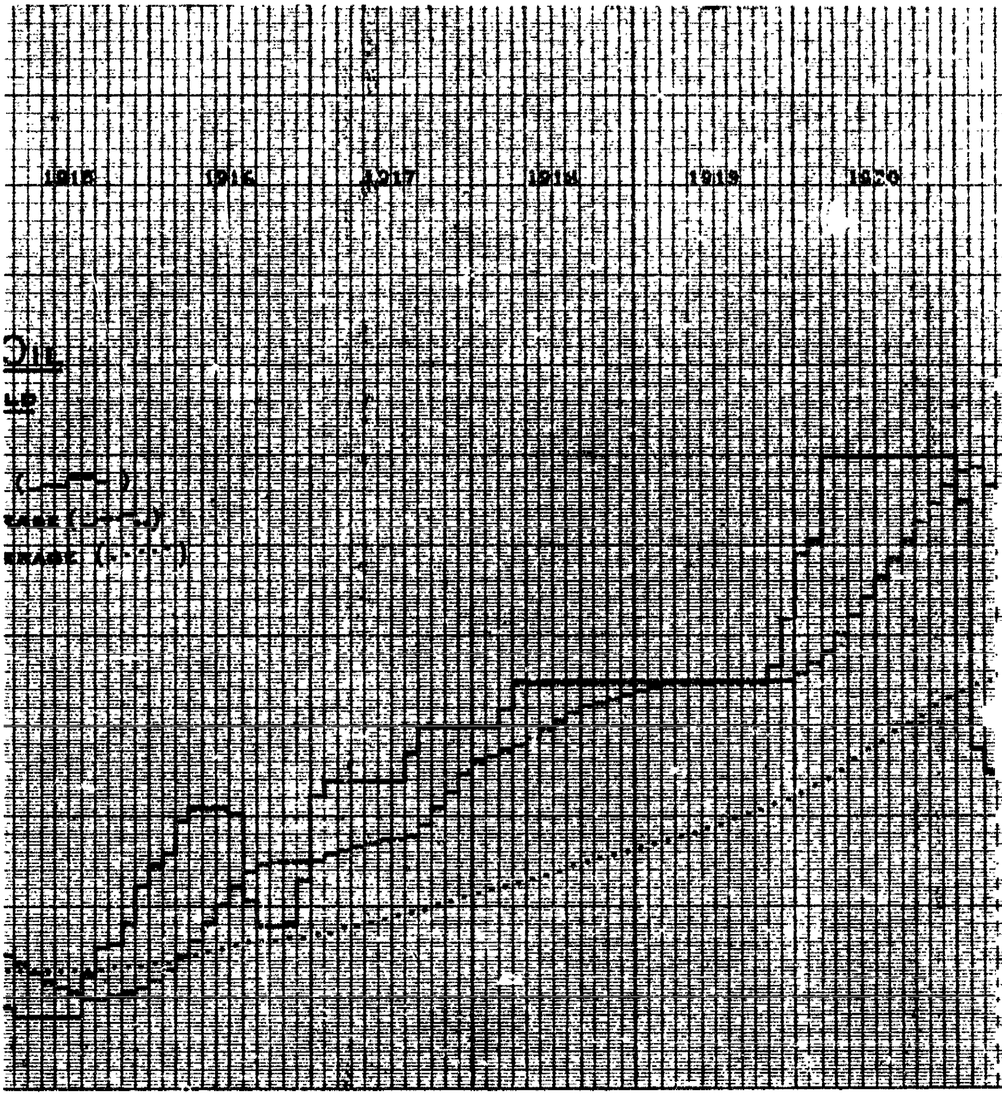
PRICE HAZARD

The hazard incident to the possibility of a decline in price directly affects the expected profit per barrel, and can not be provided for except by discounting expected profits. Such hazard is not overcome by discounting or underestimating reserves. The extent of the price hazard depends entirely upon the basis upon which the expected price was estimated. The question is, What average profit can the purchaser expect with the same assurance with which he can expect the interest upon a guilt-edge bond? If there is any probability of a decline in price below that used as the basis for estimating operating profits, this contingency must be provided for in the discount rate.

The market price of oil at the well is always subject to the most sudden and violent changes. The chart on the opposite page shows this graphically. The price obtained at the well as the oil is received is the only proper basis for valuing oil land. Any profit obtained by storing oil until prices recover are dealers and manufacturers' profits and not producers' profits.

It is obvious that if the price used is the current price and such price is low, the purchaser may contemplate a speculative profit to be realized out of a probably increase. He knows, however, that the production of his well will decline from the day of purchase and that 65 per cent or more of his oil may be recovered before a probably increase occurs. Such probability of interest if


1910
1911
1912
Price of Crude
Showing
Monthly Average Price
400
300
250
200
150
100
50


1917
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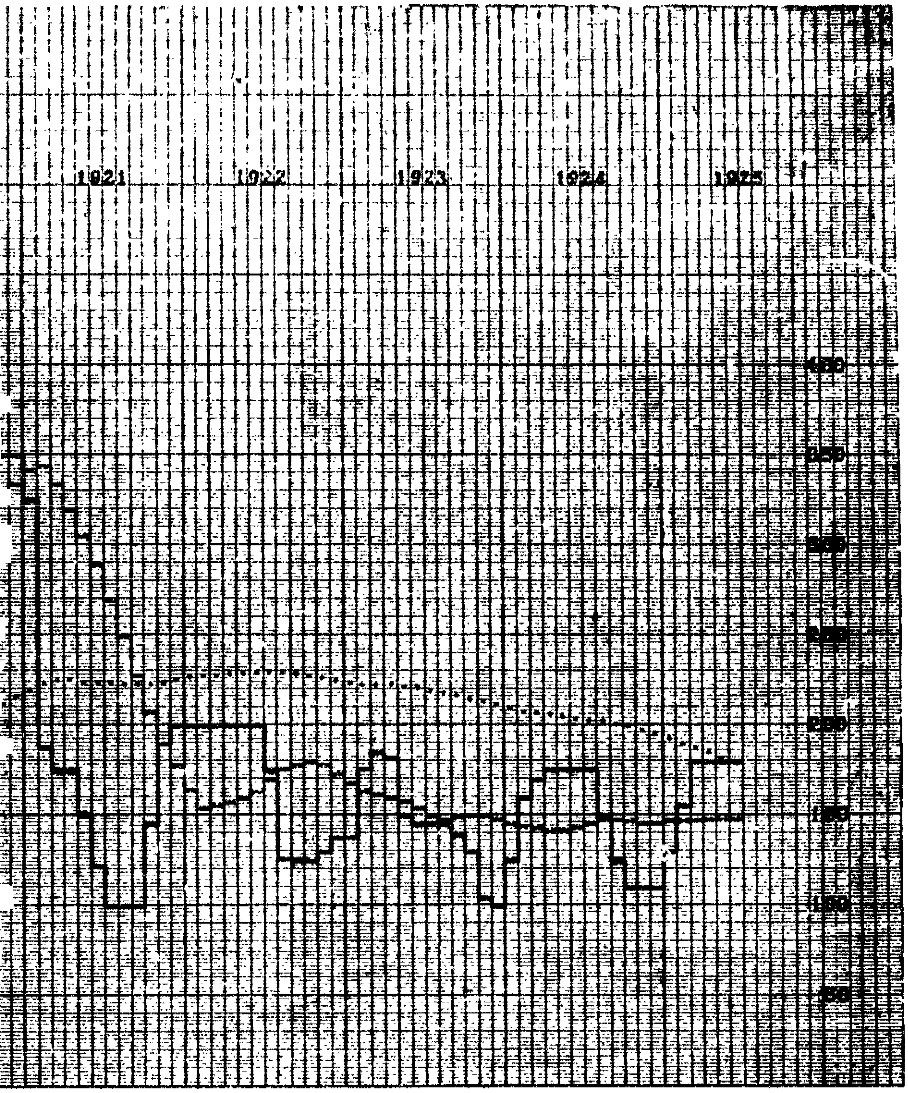
1921
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1925

realized must be considered a purely speculative gain and not a capital value.

If when oil is bringing what might be called a normal price, the current price, or even an average over a short period is used as the basis of estimating the expected operating profits, the purchaser is always faced by the possibility of one of those sharp, sudden declines which characterize the history of oil prices and which always follow the bringing in of a new oil field of any consequence. There is no way to tell when the luck of some wildcatter may bring in a new field and no way to predict how long a slump in crude-oil prices may continue. An oil well produces oil regardless of price, and neighbors may rob an operator of his reserves if he ceases drilling. Every purchaser of an oil well must discount expected profit based upon even an average normal price to meet the hazard of a decline during which his resources may be recovered.

When high prices are used as the basis of estimating the expected operating profits, the probability of being forced to sell at a reduced price becomes a practical certainty. Any purchaser of an oil well during the war period, and particularly during the 1920 inflation which followed the removal of governmental price restrictions, faced the certainty of a reduction in price for a part of his reserves and the probability of such reduction at any time. It is clear that any purchaser of oil property during the war period would have certainly anticipated a drop in price with the termination of the abnormal conditions incident to the war, and would have considered the operating profit indicated by current prices as entirely too speculative to be included in the purchase price.

It is clear that if an appraisal based upon estimated operating profits is to reflect what a purchaser would pay for an oil property within 30 days after the discovery well has been brought in, a heavy discount must be applied to meet the possibility of a decline in price, unless the price used in estimating operating profits is below normal. It is also clear that the higher the price used in estimating operating profits the greater must be the discount.

COST HAZARD

Practically all valuations of oil property which have been called to the attention of the committee have been made as of dates when every element entering into the cost of producing oil was steadily increasing. In many industries it may be assumed that an increase in cost will be accompanied by a compensating increase in price. This can not be assumed in the case of crude oil at the well, the price of which is governed by the supply and demand for oil with a practically uncontrollable supply.

If the estimates of cost are based upon current cost with no provision for this steady increase, this factor must be considered in the discount rate.

FIRE HAZARD

The fire hazard incident to oil production is so great that insurance companies will not carry it. As insurance companies do carry risks at premiums up to 5 per cent per annum, the fire hazard should be included in the discount.

DRY-HOLE HAZARD

The valuation of oil property includes the reserves under areas up to 160 acres. The valuation is required to be as of date of discovery, or within 30 days thereafter, when there is but one producing well on the property valued. The recovery of the oil valued may require a well for every 4 or 5 acres, and the costs of the additional wells are a part of the cost of recovering the oil. The statistics of the oil industry show that about 20 per cent of all wells drilled are dry holes. This is a hazard incident to the purchase of every oil property, even though such property contains a producing well.

The dry-hole hazard may affect the estimated reserve by showing that oil estimated to be under that particular acreage does not exist. The effect upon reserves can be provided for by discounting or conservatively estimating reserves.

The dry-hole hazard also increases the cost of recovering the oil actually in the reserves. To the extent that the dry-hole hazard affect costs it affects profits per barrel of oil recovered and should be provided for by a 20 per cent increase in estimated drilling costs. This has not been done in any case called to the committee's attention, nor has this hazard been considered in discounting.

WATER ENCROACHMENT AND EROSION

The hazards of water encroachment and erosion of casing also affect both production and cost. Cost is affected because the loss of a well before the recovery of the estimated production of that well increases the per barrel cost of the oil recovered.

BLEEDING BY NEIGHBORING WELLS AND OVERESTIMATES OF RESERVES

Of the eight serious hazards which face every purchaser of an oil property, only overestimate of reserves and bleeding by neighboring wells can be provided for by conservatively estimating or discounting reserves instead of anticipated profits.

PROPER DISCOUNT RATES FOR OIL VALUATIONS—STATEMENT BY REPRESENTATIVES OF INDUSTRY

The oil industry has gone on record as to what should be considered as the minimum rate of return which should be expected from the investment in oil property to provide a reasonable return upon the investment and cover the hazards of the business (1887-1883).

In the hearings on the revenue act of 1918 before the Ways and Means Committee of the House of Representatives the following statements by official representatives of the oil industry as to the rate of return are found:

The vice president of the Oil and Gas Producers' Association of West Virginia says:

> Certainly a business so hazardous and irregular should be allowed an earning of at least 20 per cent (484).

In a brief filed by the Mid-Continent Oil and Gas Association and Texas and Gulf Coast and Louisiana Oil and Gas Association, the following statement appears (473):

> We suggest that a reasonable deduction from earnings would be from 15 to 20 per cent in this business and that such a deduction would not more than equalize the difference in hazard and risk between this and other business enterprises.

Mr. John J. Shea, an attorney of Tulsa, Okla., representing the Mid-Continent Oil and Gas Association, questioned by Mr. Sterling, says that it requires an earning of at least 15 per cent to attract capital to the oil business (439).

The foregoing statements were made with reference to the excess-profits tax to support their contention that such tax should only apply to the earnings of oil producers in excess of from 15 to 20 per cent of their invested capital. It was the contention of the oil industry that from 15 to 20 per cent was the minimum normal return which must be expected to attract capital to the oil business.

STATISTICS OF EARNINGS

Some idea of what return the investor in oil property expects may be derived from statistics of what is actually earned upon such investments.

For use in the application of the special assessment provisions of the excess-profits tax law, the Income Tax Unit has assembled data as to the earnings and invested capital of oil producers which have been selected by the unit as "representative" companies. The totals for 80 to 115 companies for 1918, 1919, and 1920 are shown in the following table:

Oil-producing companies

	Year 1918	Year 1919	Year 1920	Total
Number of companies	102	115	80	
Gross income	$284,955,245	$338,315,023	$380,027,720	$1,003,297,988
Depreciation	$12,424,083	$11,968,261	$8,819,102	$33,211,446
Depletion	$18,188,848	$18,730,451	$16,381,431	$53,300,730
Net income	$58,664,081	$47,480,067	$45,608,339	$151,742,487
Per cent depreciation to net income	21.2	25.2	19.3	21.9
Per cent depletion to net income	31.0	39.4	35.9	35.1
Profits tax	$15,537,174	$6,906,768	$7,522,636	$29,966,578
Per cent profits tax to net income	26.5	14.5	16.5	19.7
Invested capital	$300,871,056	$264,526,689	$206,230,963	$771,628,708
Per cent income to invested capital	19.5	17.9	22.1	19.7

The foregoing table shows that these representative oil-producing companies actually made a profit of 19.7 per cent on their invested capital. As will be noted, these profits are arrived at after deducting depletion. As we know that the invested capital allowances were generally excessive and will shortly show that the depletion allowances are inflated, the average of 19.7 per cent is an irreducible minimum. The reduction of the depletion allowances alone to a reasonable amount will increase the earnings of these companies to from 25 to 30 per cent on their invested capital.

In considering both the statements of the representative of the oil industry quoted above and the statistics above shown, it must be borne in mind that these figures are based upon actual earnings and not estimated earnings. Even these rates are inadequate to reduce prospective earnings to present values if the prospective earnings are based upon high prices.

Furthermore, the above-quoted rates are already reduced by all losses sustained. The purpose of an investor is to protect himself against losses, and to do this the anticipated earnings of any individual property must be discounted by more than the average rate of return expected, that the net result from all property operated may equal the averages shown above.

The only sound means of arriving at proper discount factors to apply to the method of estimating expected profits followed by the Income Tax Unit is by determining the actual relationship of income tax estimates of expected profits to actual values disclosed by actual sales. As all of such sales involve either taxable profit or deductible loss and are shown by the returns, the Income Tax Unit has the necessary data for this purpose. No systematic effort to utilize this data to determine discount factors for oil valuations has ever been made.

One case presented to the committee illustrates how such data may be utilized and at least indicates the results which may be expected.

BLACK AND SIMONS CASE

(2769–2788)

Black owned a forty-nine-one-hundred-and-forty-fourth working interest in a lease in Oklahoma. Simons owned a thirty-five-one-hundred-and-forty-fourth interest in the same lease. One well was brought in upon the interests of both Black and Simons. Black, who owned the larger interest, claimed and was allowed a value of $270,059, while Simons, who owned the smaller interest, was allowed a value of $533,887. Had Simons's share in this lease been valued on the same basis as Black's share, Simons's value would be $192,885 instead of $533,887.

The Black interests, together with some other leases, were sold within the 30-day period for $300,000 cash, and the accuracy of the $270,059 value given to his share of this lease is verified by this sale. The fact is that the valuation was made after the sale and was made to reflect the sale price.

To bring Simons's valuation down to the basis of value established by Black's sale it would be necessary to use a 78 per cent discount rate applied at the end of the year, or a 125 per cent discount rate applied at the middle of the year. The 125 per cent rate would be comparable to the 10 per cent rate used in this case, as the 10 per cent was applied in the middle of the year.

A comparison of the factors used in making these two valuations demonstrates the enormous discount factors which must be applied to the inflated estimates of prospective profits made by the Income Tax Unit to bring the valuation down to a basis comparable with the value of the same property fixed by an actual cash sale.

The well on this property was brought in on June 2, 1919, at about 700 barrels per day. In July subsequent drilling brought the production to 1,000 barrels per day. Early in August further drilling increased the production to 1,600 barrels per day.

In the Black valuation the discovery date is fixed at July 3, 1919. In the Simons valuation the discovery date is fixed at August 5, or 63 days after the 700-barrel well had been brought in.

The only thing in common between the two valuations of this one property is the daily production as of date of discovery, which is given as 2,000 barrels per day, or 1,000 barrels per day in excess of production on Black's discovery date and 400 barrels in excess of production on Simons's discovery date and the discount rate.

In the Black valuation the price of oil used was $2.25 per barrel and in the Simons valuation the price used was $2.50 per barrel. The posted price on both dates was $2.25 a barrel. In the Simons valuation a 25 per cent premium was claimed and allowed. This same premium was claimed by Black but was disallowed by the Income Tax Unit.

The Income Tax Unit estimated the additional development and equipment cost necessary to recover the reserves at amounts which averages in Simons's case 23.7 cents per barrel and in Black's case 49.3 cents per barrel.

The operating expenses were estimated at 21 cents per barrel for Simons and 82 cents per barrel for Black. The net operating profit was estimated at $2.051 per barrel for Simons and at $0.935 for Black.

The present value of the oil in this property for the purpose of allowing depletion to Black was allowed at 79.713 cents per barrel, while the same oil for the purpose of Simons's depletion is $1.7647.

Furthermore, the expense of future developments and equipment was deducted from profit before discounting to present worth in Simons's case while it was deducted after discounting to present worth in Blacks's case. The effect of this is that only the discounted cost of development is deducted from the present value of the expected profits in the Simons's case, whereas the entire cost was deducted in Blacks's case. Deducting the cost of future development before discounting attributes no profit to the investment necessary to recover the value attributed to the oil and attributes the whole present value of the expected profits to the oil alone. Discounting the expected profits to present worth and then deducting development expense attributes the same rate of profit to the money invested in development as is attributed to the investment in oil, and reduced the present value of the oil by the profit attributed to development.

It is the standard practice of the Income Tax Unit in oil valuations to deduct development expense before discounting. In all other valuations the opposite practice is followed. Oil producers are assumed to invest in development pro bono publico, while mine owners are assumed to expect a profit on plant and development at the same rate as the profit expected on the ore in the ground.

It is reasonable to assume that if the market value of a lease on oil land is $100,000, and it will cost $50,000 to drill and equip the property, a buyer will expect the same profit on the $50,000 necessary to recover the oil as is expected on the $100,000 paid for the lease. He will measure his rate of return on an investment of $150,000, and not on the $100,000 paid for the lease. He must get $165,000 operating profit out of the well to return his capital and return him a net profit of 10 per cent.

By attributing all profit to the oil and nothing to the development expense, the bureau would consider a $15,000 net profit in such case as a 15 per cent profit.

Assuming the operating profit to be $165,000 and a gross discount of 10 per cent, the two methods are illustrated as follows:

Bureau method applied to Simons

Estimated operating profit	$165,000
Deduct development expense	50,000
Value of oil and return on investment	115,000
Discounted at 10 per cent equals present value of oil	104,545

Deducting after discounting as in Black case

Estimated operating profit	$165,000
Discounted at 10 per cent equals present value of oil and development	150,000
Deduct development cost	50,000
Value of oil	100,000

As $100,000 was the assumed value we started with, the above computations prove that it is necessary to deduct the development expense after instead of before discounting to get the value of the oil only.

As will be shown in all valuations by the analytic appraisal method for any purpose except oil the cost of development and equipment is deducted from the discounted value of the expected profits, and a profit is thus attributed to the entire investment instead of to the mineral only. There has been no explanation of why all other natural resource industries are thus discriminated against in favor of the oil industry.

The net result of this determination is that, while both Black and Simons have undivided interest in every barrel of oil from this property, one was given depletion at the rate of 80 cents per barrel and the other at the rate of $1.76 per barrel.

This discrepancy is due to the fact that an actual sale necessitated valuing the property so far as Black was concerned at the real market value determined by the sale, while an income tax valuation was used to allow Simons 125 per cent more depletion on the same oil

Mr. Gregg presented an answer on behalf of the Commissioner in this case, in which he says (2801):

> Simons did not accept the valuation given him by the engineering division and is now going to appeal to the Board of Tax Appeals on the question, so his case is still pending and is not disposed of and will not be disposed of until the Board of Tax Appeals has passed on his claim. After decision by the Board of Tax Appeals in his case, the Black case will then be reopened—that will be after the final decision in the Simons case—and the same valuation will be given to Black that is found to be due Simons by the Board of Tax Appeals.

The Board of Tax Appeals can increase the valuation allowed Simons but can not reduce it. To reduce the valuation would increase the deficiency in tax already determined by the commissioner, and this the board has no jurisdiction to do. The Board of Tax Appeals can do no more than determine that the Simons value as determined shall stand or be increased.

The effect of the commissioner's answer, therefore, is that Black's depletion, now determined upon a basis verified by his actual sale, will be increased by at least 125 per cent to be comparable with Simons's inflated valuation. Thus, to meet the objection that there is discrimination in allowing depletion on actual value to one taxpayer and on an inflated value to another we are assured that the wrong will be righted by making them both equally wrong.

This Black and Simons case brings out very forcibly the fact that no such average rates of profit as the oil industry claimed before the Ways and Means Committee and as would be shown by statistics of the per cent invested capital earned would be adequate to reduce Income Tax Unit estimates of expected profits from oil property to anything like market value as shown by actual sales. To apply discount rates based upon actual earnings, it is necessary to reduce the estimates of expected profits to a conservative basis, as the Income Tax Unit was forced to do, to bring the Black valuation to the value actually determined by actual sale.

ALL HAZARDS IGNORED IN VALUATIONS OF OIL PROPERTY

As will be shown by cases which will be referred to, the Income Tax Unit has no consistent policy with reference to the price which is to be used in estimating the prospective profits of an oil property and no sound policy with reference to discounting expected profits.

Mr. Greenidge testified that the market price of oil at the date of discovery or within 30 days thereafter is used as the price upon which operating profits are estimated (239). It has been established that if the peak market price within the 30-day period is the highest price for which any excuse can be offered, it is always used. If a higher price can be obtained by averaging prices over a period or by anticipating a raise, that also is permitted. While increases are anticipated when oil within the 30-day period is low, no decreases are anticipated either in the price or through the discount factor when oil is high. Such policy as the oil and gas valuation section has, if it can be said to have any, seems to be predicated upon the theory that oil is always liable to go up but is never liable to come down.

The discount policy is on a par with the price policy. Mr. Greenidge's theory that the discount is an inconsequential factor which he would ignore entirely is reflected in the work of the oil and gas valuation section. In some valuations the first year's operating profits are not discounted at all and the discount rate applied to subsequent years' estimated anticipated profits are negligible, notwithstanding the fact that such profits are based upon peak prices.

On March 27, 1924, Mr. Greenidge testified that the discount rate in oil valuations is "a different rate for practically every field and different rates for different operators in the same field, depending, of course, upon the peculiar circumstances in each case" (330).

At the time Mr. Greenidge made this statement to the committee there was in force in the oil and gas valuation section an order promulgated in July, 1913, which is as follows:

> Since the regulations provide for a discount and since Hoskold's 10 per cent discount table modified to indicate the present worth of the unit realized at the middle of the first fractional year and at the middle of each calendar year thereafter is reasonable and conforms with current practice, this table should be used in all valuations established by appraisal methods.

On February 2, 1924, or less than two months before making the above-quoted statement to the committee, Mr. Greenidge received the following memorandum from the chief of the oil and gas valuation section:

FEBRUARY 2, 1924.

Mr. S. M. GREENIDGE,
Head, Engineering Division.

The discount rates applied by the oil and gas section are as follows: *Hoskold, 10 per cent* semiannual; *Hoskold, 8 per cent* annual.

The 10 per cent semiannual discount rate was adopted by the oil and gas section several years ago because it was believed it represented in some degree the risk involved for average oil and gas properties in addition to the interest rate on money.

The 8 per cent annual rate has been used on occasions where the risk involved was materially less than the average, as in the Glenn pool. This rate has been used only on March 1, 1913, valuations.

In individual cases several other rates have been applied where it was demonstrated that such procedure was necessary.

W. N. THAYER,
Chief, Oil and Gas Valuation Section.

In the Gulf Oil Corporation cases prices above the posted price of oil were used in some instances, and a large percentage of the estimated operating profits were not discounted at all.

GULF OIL CORPORATION

Nothing has been done to determine the taxes of this taxpayer for any year since 1919. The values allowed this taxpayer for discovery depletion on discoveries claimed from March 1, 1913, to December 31, 1919, amount to $93,717,927 (2792). Depletion allowances based on these valuations are deducted from income as the oil is recovered until the full value allowed has been deducted or until the oil is exhausted. Thus depletion on a large amount of these values is still going on.

The discovery depletion allowed to be deducted from income for 1918 was $10,173,769, and for 1919 was $10,401,256 (2796). These figures fairly indicate the average annual deductions from income for discovery depletion by this taxpayer (2795).

The effect of these discovery depletion deductions on the taxpayer's taxes for 1918 and 1919 is as follows (368):

1918

Tax without deducting discovery depletion from income	$8,777,684.52
Tax after deducting discovery depletion from income	1,902,532.33
Reduction in tax due to discovery depletion	6,875,152.19

1919

Tax without deducting discovery depletion from income	2,579,127.14
Tax after deducting discovery depletion from income	307,011.53
Reduction in tax due to discovery depletion	2,272,115.61

A large number of valuations allowed the producing subsidiaries of this company showed that no hazard factors were used and in 30 out of 70 cases a price of oil largely in excess of the posted price was used as the basis for estimating expected profits. In nearly every instance the expected operating profit from the first year's estimated production was not discounted and 5 per cent applied to the middle of the year was used as the basis for discounting the operating profits for years subsequent to the first year (2793).

The use of these factors result in values for discovery depletion, which exceed what would be derived from the use of prices and discount commonly applied to other taxpayers. The discriminatory excess valuation is estimated at about $50,000,000, which will be returned tax free during the life of the property valued. Valuations in accordance with the usual practice of the Income Tax Unit would increase the taxes of this taxpayer by an amount estimated to be $4,590,385.61 (2795).

The deductions for 1919 and prior years can not be reconsidered, as the taxes for 1919 and prior years were closed by an agreement under section 1312, signed August 11, 1923 (2795). As deductions based upon these valuations were and are being made for 1920 and subsequent years, these valuations can be and should be reconsidered, and at least reduced to the standard commonly applied to other oil companies, if not to figures representing the fair market value of the property.

Illustrative Cases

GULF OIL CORPORATION AND SUBSIDIARIES

SHUMWAY LEASE OF GYPSY OIL CO.

(199–2006)

The discovery well No. 1 is the basis of a valuation on 40 acres. This well was brought in on July 15, 1917, and the discovery date claimed and allowed was August 14, 1917, or the last day of the 30-day period permitted by the law.

On August 14, 1917, and for six months prior thereto, the posted price of oil in the mid-continent field, where this well was located, had been $1.70 per barrel. This was the highest price on record for oil in that field. On August 15, or one day after the expiration of the 30 days after discovery, the posted price advanced to $1.90. The operating profits of this property were estimated by using $1.90 as the anticipated price.

Under its lease the Gypsy Oil Co. was entitled to seven-eighths of the oil recovered, the balance going to the lessor, although the Gypsy company was obligated to stand all expense of recovering all of the oil.

At $1.90 per barrel, the prospective gross receipts of the Gypsy company were estimated at $10,144,126.60. The expense of drilling, equipping, and operating was estimated at $1,953,734.48, leaving $8,190,392.12 as the estimated prospective operating profit. The value allowed on this property for depletion purposes as of July 16, 1917, was $8,161,398.13, which allowed $28,993.99 to cover all risk of not recovering the full estimated operating profit and for a net profit on the investment.

During the 30-day period after discovery this well actually produced 130,954 barrels of oil and during this entire period the price of oil was $1.70 per barrel. As the entire estimated production had been valued at $1.90, a loss of 20 cents per barrel was suffered before the expiration of the 30-day valuation period. Thus

$26,190.80 of the $28,993.99 estimated net profit had disappeared before the close of the valuation period, leaving only $2,803.19 to cover all the risks of the oil business and a profit on an investment of $8,161,398.13. As the attorneys' fees and expenses of preparing and recording deeds on a transaction of this size would certainly exceed $2,803.19, this valuation assumes that investors could be expected to pay more for the property than the total estimated operating profits, after such operating profits had been inflated, by using a price of oil 20 cents per barrel in excess of the most that oil in that field had ever been sold for. This value is predicated upon the absurd proposition that investors in oil property will gamble on a 20-cent raise in price and still pay more than they can hope to recover in operating profits if they get it.

The discovery well had an initial production of 5,000 barrels per day, and the production estimates contemplate that nine more wells will be required to recover the reserves the production of which will average 75 per cent of that of the discovery well. It is estimated that 95 per cent of the oil will be recovered during the first year and that the entire reserves will be recovered within four years.

Subsequent developments have shown that the reserves were not overestimated, but facts brought out by subsequent developments would not be available to a purchaser of this property within 30 days after discovery. Such a purchaser would be governed by past experience in that particular locality.

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

(A) Where the fair market value of property at a specified date in lieu of the cost 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 mineral product. The value sought should be that established assuming a transfer between a willing seller and a willing buyer as of that particular date.

The "conditions and circumstances known at that date," July 15 to August 14, 1917, were vastly different than those upon which this appraisal was based and are so similar to those disclosed by subsequent developments that the conclusion is inevitable that the value in this case was based entirely on subsequent developments.

In the first place the fact that a price of oil was used which had never been reached in this field during or before the valuation period, but which was reached one day after the close of the valuation period, is conclusive that subsequent developments were not only available for the purpose of pricing future production but were actually made retroactive by giving oil which had been produced during the 30-day period at $1.70 a value of $1.90.

Water was a serious menace in this oil field as early as 1915, and the wells in this field had an indicated life of 11 years instead of 4 years estimated in this case.

The nine additional wells are estimated to have an average daily production of 3,750 barrels each, and the actual production of these nine wells was 3,850 barrels. There is nothing in the history of this field prior to the expiration of 30 days after this well was brought in upon which to predicate any such estimate.

The United States Geological Survey records 5,098 wells drilled in this county during the years 1914 to 1920, inclusive. Fifteen per cent of these wells were dry holes and 5 per cent were gas. Only 80 per cent produced oil, yet this estimate contemplates no dry holes. The wells drilled in this county in 1914 averaged intial production of 9.4 barrels per day. The average initial production of wells drilled in subsequent years was as follows: 1915, 15.1 barrels per day; 1916, 255.8 barrels per day; 1917, 290.6 barrels per day. It is evident that there was nothing in the past experience in this field on August 14, 1917, which would warrant the assumption that every well drilled on a lease in this field would produce oil and that the initial rate of production of every well drilled would average 3,750 barrels per day.

In the light of these facts, can it be assumed that any sane man would even consider paying $8,161,398.13, the value allowed in this case, for $8,164,201.32 of estimated future earnings, to be recovered in four years, when he knew that he was assuming a known water hazard, and that such estimate of earnings was based upon the assumption that he would realize 20 cents per barrel more than oil had ever sold for and that his production would be thirteen times as great as the highest known actual production in that field?

It was assumed all through the early hearings that the estimated operating profits were discounted at the rate of 5 per cent in determining the values used for depletion by the Gulf Oil Co. The discount rate used in valuing this Shumway lease is actually thirty-four one-hundredths of 1 per cent. The 5 per cent is a fiction based upon the method of discounting. The first year's profits which are estimated to be in excess of 95 per cent of the total are not discounted at all. The recovery of the operating profits estimated for the first year are considered to involve no risk, and the value of the use of 95 per cent of the $8,000,000 to be paid for these first year's profits pending the recovery of the profits is considered to be nothing.

The second, third, and fourth year's operating profits are discounted at the middle of the year at 5 per cent. As we have shown, this produces a result of less than 5 per cent. The second year's profits are discounted at 5 per cent for 18 months instead of 2 years, the third year's profit are discounted at 5 per cent for 2½ years, and the fourth year's profits are discounted at 5 per cent for 3½ years. By thus failing to discount the first year's profits, and by applying the discount of subsequent years to the middle instead of the end of the year, the actual discount rate applied in this case is about thirty-four one-hundredths of 1 per cent per year. This is supposed to cover all of the risks incident to the oil business and provide the expected return on the $8,161,398 invested in the property.

The depletion unit allowed this taxpayer on this property was $1.528 per barrel. As the cost of developing, equipping, and operating was estimated at 36.6 cents per barrel, the cost and depletion amount to $1.894 per barrel, which leaves a margin of expected net profit of six-tenths of 1 per cent per barrel.

LESSOR'S ALLOWANCE ON SAME PROPERTY

(2101)

Mrs. Atlanta G. Winchester was one of the colessors of the property upon which the Gypsy Oil Co. was allowed the above-discussed valuation. The depletion allowance granted this lessor upon her interest in the very same oil was $1.0833 per barrel. As the lessor had no expense of developing, equipping, and operating the property, her actual value per barrel exceeded the value of the Gypsy Oil Co. by 36.6 cents. Reducing the lessor's depletion unit to a basis comparable with that of the Gypsy Oil Co., it is $0.7173 per barrel.

If we assume that the lessor's interest was property valued, we can determine a value of the Gypsy Oil Co.'s interest on the basis of the allowance to the lessor by deducting the costs of recovering the oil, 36.6 cents, from the lessor's depletion unit, $1.0833, and by multiplying the difference, $0.7173, by the Gypsy Oil Co.'s estimated reserves of 5,339,014 barrels. The result, $3,829,675, is the value of the Gypsy Oil Co.'s interest in this property when valued on the basis applied in determining the value of the lessor's interest. As the value allowed the Gypsy Oil Co. was $8,161,398, the excess over the value as determined for the lessor is $4,331,723, or 113 per cent.

This Shumway lease contained three 40-acre tracts not included in the value of well No. 1 discussed above, upon which three additional discovery values were allowed. The total value for the 160 acres allowed the Gypsy Oil Co. was $10,020,325. The total value of the Gypsy Oil Co.'s interest on the basis of value allowed the lessor would be $5,436,698.

Here, as in the Black and Simon case, we have two different values allowed on the same property for two different taxpayers, both of whom have undivided interests in the same oil. The only difference between the two is that the lessor takes no risk of the profit on her oil, being decreased by increased expense of drilling, equipping, and operating the property, yet the lessee, who assumes the greater risk, gets a value of about twice what it would be if computed on the basis applied in determining the value of the lessor's interest.

VALUATION OF SHUMWAY LEASE TYPICAL OF ALL GULF OIL CORPORATION VALUATIONS

The valuation of the Shumway lease is a typical illustration of the factors and methods used and the values allowed on all of the property of the Gulf Oil Corporation and its subsidiaries.

When the posted prices during the valuation period were peak prices, expected operating profits were based on the highest posted market price. When a rise in price followed the expiration of the valuation period, such rise was anticipated. and when a higher price could be obtained by averaging posted prices, that was done. No uniform nor consistent policy was followed, except to take the highest price, for which any excuse, on any basis, could be offered. An examination of the valuation of 70 leases of the Gypsy company showed that in 29 out of the 70 cases, a price above the highest posted price of oil during the valuation period, was used in estimating operating profits (1985–1991).

The value allowed for 12 of these leases, aggregating $256,056.15, were inflated $100,656.05 by excessive estimates of expected profits, due to the use of an excessive price of oil (1998).

The method of discounting, followed in valuing the Shumway lease is typical of all valuations. From 90 to 95 per cent of the expected operating profits are estimated to be recoverable during the first year. These estimated profits are not discounted at all. Operating profits estimated to be recoverable during the succeeding years are discounted at 5 per cent, applied to the middle of the year.

In a table on page 2105 of the hearings, the valuation of seven leases is shown. The estimated operating profits from these seven leases is $1,256,694, and these leases are valued at $1,161,680. The lives of these properties are estimated at from 6 to 16 years. Assuming that the estimate of operatings are correct, the net profits will be $95,014 of 8.18 per cent on the investment, to be returned in from 6 to 16 years.

On page 2106 of the hearings appears a table, showing 53 valuations allowed the Gulf Production Co., a subsidiary of the Gulf Oil Corporation.

Thirty of these properties have estimated lives of 14 years. The aggregate estimated recoverable profits is $4,492,977, and the aggregate value is $3,983,469.46. This leaves $509,508.13 of net profit or 11.34 per cent to be recovered in 14 years.

Twenty-three of these properties have estimated lives of 3 years. The aggregate estimated operating profit is $19,035,086.72 and the aggregate of the value is $18,607,526.33. This leaves for a return upon the investment and to cover risk of $427,560.39 or 2.3 per cent to be recovered in 3 years.

DEFENSE OF BUREAU-GULF OIL CORPORATION

It has been urged in defense of these valuations that in some instances the properties have actually returned more value in oil than the valuations allowed. This defense is ridiculous. It assumes that the Gulf Oil Corporation was not expected to pay any taxes.

No buyer of an oil well, on the date of discovery or within 30 days thereafter, has all of the subsequent experience as to prices, expenses of operation and amount of production upon which to base an estimate of value.

The value contemplated by the law, as the basis for discovery depletion, is that value which is apparent from conditions existing at the date of discovery, or within 30 days thereafter, and not that value which subsequent experience may develop. The future production having been estimated, and the highest prices for which any plausible excuse could be given, having been adopted, subsequent development can neither excuse nor justify the failure of the Income Tax Unit to discount the estimated profits by a factor adequate to cover the risk involved in the use of top prices and also provide a return on the investment.

The fact that the Gulf Oil Corporation may not be able to receive depletion on all the reserves time may develop does not alter the fact that it has, during the high-tax years, received exorbitant allowances, which can not be justified upon any basis. The oil industry generally has received excessive allowance for depletion, but the allowances to the Gulf Oil Corporation, in the high-tax years, are so excessive as to constitute a gross discrimination against even the oil industry.

From the depletion allowances and net incomes of 16 large oil companies comparable to the Gulf Oil Corporation, we have computed the per cent of depletion to net income and have compared this with the per cent of depletion to net income allowed the Gulf Oil Corporation, as follows:

Year	Per cent depletion to net income, average of all companies on Exhibit I, except Gulf Oil Corporation	Per cent depletion to net income, Gulf Oil Corporation
1917	37.8	20.7
1918	27.6	177.9
1919	48.2	448.6

In considering the above figures it will be borne in mind that discovery value was not allowed as a basis of depletion until 1918. The marked change in the Gulf Oil Corporation relative percentage of depletion will be noted in 1918 and 1919.

It has also been shown from figures submitted by the bureau that the tremendous increase in the depletion allowances for 1918 and 1919, due to discovery depletion, based on the kind of valuations we have been discussing, decreased the per cent of net income to invested capital of the company from 31.3 per cent in 1917 to 10.9 per cent in 1918 and to 3.7 per cent in 1919.

Union Oil Co. of California

(3024–3025)

This case is typical of the methods used in valuing California oil property. In this case developed leases owned by the taxpayer on March 1, 1913, are values as of that date. The posted price of California oil on March 1, 1913, was 60 cents, and experience prior to that date indicated that as of that date 60 cents was a normal price. In making these valuations it is assumed that the price of California oil will increase at the rate of 5 cents per barrel per annum (3024). The same practice was followed in all valuations of California oil property.

The average price of California oil for the ten years prior to March 1, 1913, was 39.8 cents per barrel and the highest average price for any one year prior to March 1, 1913, was 56 cents in 1909. There is absolutely nothing upon which to base a prediction on March 1, 1913, that the price of California oil will increase at the rate of 5 cents per annum.

In making discovery valuations, as of 1920, when the posted price of California oil was from $1.60 to $1.88 per barrel, the posted price of oil was used, and no decline was anticipated.

Notwithstanding this basis of pricing, estimated operating profits were only discounted at 10 per cent, applied to the middle of the year.

CONNELLY AND LARKIN

(2974–2975)

Connelly and Larkin each owned nine one-hundred-and-twenty-eighths of the working interest in a lease. The balance of the working interest in this property was owned by six other parties. One of these parties was allowed depletion on cost, and the depletion of two of the owners has not been fixed by the department. The depletion units allowed five parties, each owning an undivided fractional interest in the same property, and the value of the entire working interest, based upon the depletion allowed each of these parties are as follows:

	Depletion unit (per barrel)	Value of entire working interest
J. J. Larkin	$0.4166	$152,528.59
E. W. Sinclair	0.5115	187,274.06
Seth Ely	0.5115	187,274.06
E. L. Connelly	0.79655	291,638.62
Frank L. Moore	1.27	464,981.54

In another lease the depletion units allowed to the owners of undivided fractions of the working interest were as follows:

J. J. Larkin	$0.28534
E. L. Connelly	.33722
Margay Oil Co	.60
Gypsy Oil Co	.7174

There is something radically wrong with any system which gives these widely different values to the same barrel of oil, coming out of the same hole and sold at the same time for the same price.

CONCLUSION—OIL VALUATION

The general policies of the oil and gas valuation section may be summarized as follows:

By estimating anticipated profits on the basis of the highest possible price, the hazard of actually recovering the profits estimated is increased to the maximum.

The discount factors used, when applied by the mid-year method of discounting, are inadequate to cover the bare use of the money invested and makes no provision for either the probable decline in price or any other hazard incident to the oil-production business.

The result is grossly excessive valuations and correspondingly excessive depletion allowances, particularly in the high-tax years.

Oil valuations are so loosely made that they can not be said to be upon any consistent basis. Where it is possible to test valuations by comparing two or more valuations of the same property, the lack of any similarity shows a total lack of system and competent supervision. If the valuation of any two oil properties by the Income Tax Unit are consistent, it is a mere coincidence.

The general overestimating of expected profits per barrel from oil and the failure to adequately discount estimated profits results in gross discrimination against all other taxpayers, and the lack of system, policy, and supervision results in gross discrimination between oil producers.

Status of Work in Oil and Gas Valuation Section

The work of this section is so far behind that up to March 1, 1925, practically all effort was concentrated on valuations for 1919 and preceding years.

In March, 1925, the engineering division had 1,318 more 5-year-old cases undisposed of than in March, 1923, a loss of progress of 207 per cent in two years.

This condition is due primarily to the granting of interminable extensions of time to taxpayers, to furnish information, and to granting conferences and hearings until the taxpayer has bargained for a tax he is willing to pay. The Union Natural Gas Co. case (2977), a chronological history of which follows, is typical of many cases. Other cases illustrating the lack of terminal faculties in the oil and gas valuation section are the Mascot Oil Co. (2978–2980), A. G. Kennedy and W. A. Springer (2981–2989), Shell Oil Co. of California (3001), Standard Oil Co. (100–120), and Sinclair Oil & Refining Co. (2991).

Union Natural Gas Co. of Pittsburgh, Pa.

(2977–2978)

A review of the files of this case shows that there is still pending an additional tax of approximately $200,000 for the year 1917. There have been apparent delays on the part of the taxpayer and the department has not been able to close this case for any year.

The following chronology best illustrates the conditions prevailing in this case:

May 29, 1918: Schedules filed answering questions in the 1917 tax returns.
March 19, 1919: Taxpayer requested to file valuation data.
April 3, 1919: Second request asking for valuation data.
April 4, 1919: Taxpayer desires to comply with request for valuation data and asks extension of time and conference.
April 8, 1919: Conference granted for April 16.
April 16, 1919: No conference memorandum.
January 26, 1920: Taxpayer asks for ruling regarding drilling expenses.
April 19, 1920: Taxpayer asked to file affiliated questionnaire.
May 26, 1920: Second request for affiliated corporation questionnaire.
July 21, 1920: Third request for affiliated corporation questionnaire given to August 16 to reply.

December 4, 1920: Taxpayer refers to letter of January 26, 1920, asking for ruling on method of handling labor and drilling costs for gas wells.

January 4, 1921: Taxpayer reminds department in answer received in reply to letters of January 26, 1920, and December 4, 1920.

December 9, 1920: Affiliated corporation questionnaire received by department.

January 13, 1921: Coal valuation section asks for date to substantiate coal land values.

January 22, 1921: Taxpayer asked to file consolidated income and profits tax return for 1919.

February 4, 1921: Coal valuation reports mailed by taxpayer.

February 12, 1921: Taxpayer advised regarding drilling costs per request of December 4, 1920.

August, 1921: Form O oil and gas valuation data for 1917, 1918, and 1919 received.

October 10, 1921: Taxpayer asks for conference. Conference arranged for October 18.

December 13, 1921: Taxpayer preparing amended returns for 1917 to 1920, asks status of case.

December 27, 1921: Valuation oil and gas properties in progress by oil and gas section.

January 3, 1922: Taxpayer asks for extension of time for filing amended returns.

January 10, 1922: Extension granted to February 15, 1922.

February 18, 1922: Taxpayer asks for 90 days' extension to file amended returns.

February 28, 1922: No extension granted.

March 1, 1922: Taxpayer asks further extension.

March 18, 1922: No extension granted.

November 7, 1922: Letter to taxpayer explaining valuation methods.

January 29, 1923: Revenue agent's report filed showing additional tax for 1917, $232,440.70.

February 1, 1923: Conference oil and gas section.

April 30, 1923: Taxpayer asks for conference.

May 2, 1923: Conference granted May 10.

May 11, 1923: Conference oil and gas section, discoveries disallowed.

January 10, 1924: Assessment letter showing additional tax for 1917, $198,190.75; for 1918, $2,719.30. This letter shows that taxpayer paid for 1917, $446,676.13, and for 1918, $289,400.58. The consolidated net income for 1917 was $3,330,798.48, while the aggregate net income for 1917 was $4,553,827.21. The consolidated invested capital for 1917 was $13,448,957.62.

February 8, 1924: Protest filed regarding A-2 letter January 10, 1924.

May 2, 1924: Taxpayer asks for conference May 13, 1924.

May 13, 1924: No conference memorandum.

July 22, 1924: Conference held in oil and gas section.

August 21, 1924: Conference held in consolidated audit section with request that another conference be held September 12.

September 12, 1924: Conference, consolidated audit section; certain balance sheets requested.

September 23, 1924 Balance sheets received by department.

October 21, 1924: Conference, consolidated audit section.

December 1, 1924: A 300-page revenue agent's report received covering the years 1918 to 1921, inclusive, showing additional tax due of $29,865.01.

March 14, 1925. Department refers to taxpayer's appeal and asks for additional information.

April 2, 1925. Taxpayer granted extension to April 24, 1925, to file additional information.

TAX LOST THROUGH DELAY

In the Kennedy and Springer case (2981), the Government lost a tax of about $200,000, on $2,903,353 of profits from the sale on an oil lease, because of delay until the statute of limitations barred an assessment.

EFFORTS OF HEAD OF ENGINEERING DIVISION, AND CHIEF OF OIL SECTION TO RELIEVE OIL PRODUCERS FROM TAXATION

Standard Oil Co. of California (2803–2832): This case is of great importance, as illustrating the lack of control, by the Commissioner of Internal Revenue over the engineering division of the Income Tax Unit, the general attitude of the head of the engineering division and the chief of the oil and gas valuation section toward the Government, and the oil producers, and the kind of reasoning which governs this work.

The Regulations (reg. 45, art. 223) permit an oil producer to deduct development costs, as either current expenses each year as they are incurred, or to capitalize such costs, and deduct them through depletion. This regulation provides that: "An election once made under this option will control the taxpayer's returns for all subsequent years."

Rulings published in 1921 and 1923 hold that the taxpayer exercises his option to treat development costs as expenses or depletable capital when he enters such costs upon his books, and that his return must correspond with his books in this particular.

From the time of its organization to and including 1921 it was the practice of this taxpayer to capitalize its development costs. The taxpayer's original returns conformed to this practice, and the tax computed on this basis was paid.

It was found that to convert such development costs from a capital into an expense item would reduce this taxpayer's taxes for the years 1918 to 1920, inclusive. $3,378,921.35.

It was claimed by Mr. Thayer, chief of the oil and gas valuation section, that in May, 1922, an oral agreement was entered into between the representative of the oil and gas valuation section and the taxpayer that in consideration of the waiver by the taxpayer of an unsubstantiated claim of some description, of which there is no record, the taxpayer would be permitted to file amended returns for 1918 and subsequent years, in which development costs would be deducted as current expense (2806).

This would set a precedent, under which other taxpayers could sustain claims for refunds to the amount of approximately $25,000,000 (Exhibit 12). (2825.) On September 1, 1922, the taxpayer was notified that such amended returns would be received.

On May 7, 1923, the taxpayer filed unsigned amended returns, in which development expenses were treated as capital charges (2806).

On June 9, 1923, the rules and regulations section ruled that the amended returns, changing the development costs from capital to expense charges after the taxpayer had elected to capitalize such costs, could not be received.

On July 9, 1923, the Solicitor sustained the ruling of the rules and regulations section (2820).

On September 10, 1923, Mr. Thayer recommended that, notwithstanding the Solicitor's ruling, the regulations, and all former precedents, the case be closed on the basis of the amended returns. Mr. Greenidge concurred in this recommendation. On September 29, 1923, Mr. Bright, deputy commissioner in charge of the Income Tax Unit, with all the facts before him, ordered the case closed on the unsigned amended returns, and notified the taxpayer that this would be done (2812).

The amended returns were audited and resulted in a certificate of overassessment for a refund of $3,378,921.35 (2812).

In accordance with the regular procedure this certificate of overassessment, involving more than $50,000, was sent to the Solicitor for his approval (2812).

The Solicitor, Mr. Nelson T. Hartson, in a memorandum to Deputy Commissioner Bright, under date of January 29, 1924, says:

This certificate results from permitting the company to file amended returns in which there is charged to expense various items theretofore capitalized.

This office in a memorandum to you, under date of July 9, 1923, held that as a matter of law this could not be done, and for that reason the certificate is returned to you without approval.

It is understood, however, that the proposed adjustment has been discussed with the commissioner and you should dispose of the case as directed by him. File is herewith returned (2826).

This brought the case to the attention of the commissioner, whose action is shown by the following memorandum (2829):

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, February 20, 1924.

Memorandum for Mr. Bright.

My attention has been called to your letter of September 29, 1923, in regard to the Standard Oil Co. of California, wherein you advise the company that its amended returns for 1918 and subsequent years in which intangible development items previously capitalized or charged off to expenses will be accepted, and notifying them that their case will be audited on that basis.

I think your letter is in error. It appears that you based your letter on some verbal understanding had between the conferees of the natural resources division and the representatives of the company. Any verbal understanding of an important matter like this is most unfortunate, and I do not feel that the bureau can be bound by it. In the first place, a matter of so much importance should be reduced to writing; in the second place, while great weight is given to agreements on the part of conferees, their agreements are not binding and no agreement can be binding unless it is approved by the commissioner.

This matter was called to my attention some months ago and the facts as presented indicated that perhaps the understanding between the taxpayer and the conferees should be carried out, but a thorough investigation of the file convinces me that this would establish a dangerous precedent and should not be done. You will, therefore, please notify the taxpayer.

D. H. BLAIR, *Commissioner.*

Notwithstanding the foregoing memorandum of the commissioner, the two rulings of the Solicitor, the ruling of the rules and regulations section, as well as all of the published precedents, Mr. Greenidge, as late as November 26, 1924, did not acknowledge defeat in his effort to secure this refund of over $3,000,000 for the Standard Oil Co. On November 26, 1924, Mr. Greenidge writes Mr. Bright as follows (2830):

NOVEMBER 26, 1924.

In re: Standard Oil Co. (California), San Francisco, Calif.

Mr. J. G. BRIGHT,
Deputy Commissioner.

With reference to the still undecided question of whether or not this company should be permitted to file amended returns in which development costs previously capitalized are charged to expense, your attention is invited to the attached copy of a recent recommendation from the Solicitor's office, particularly to issue No. 4.

In the case of the Standard Oil Co., a certain part of its income is impounded each year from 1914 to 1920. It appears, therefore, under the Solicitor's recommendations referred to, that this company might file amended returns reporting these impounded funds as income for the year in which they accrued. The adjustment necessary to file these amended returns would be relatively small, as the amount of funds impounded is not large, but once the right to file amended returns on any basis is conceded a precedent would be established for accepting amended returns for 1918 and subsequent years in which adjustment would be made not only for impounded funds but also for the change from capitalized development costs to expensed development cost.

It is suggested that this matter might be discussed informally with the Solicitor.

S. M. GREENIDGE,
Head Engineering Division.

This memorandum is conclusive evidence of a most deplorable situation in the Income Tax Unit. Mr. Greenidge had sole charge of all of the work of determining the allowances for depletion, amortization, values of natural resources for invested capital, and profit and loss purposes. That this vast responsibility and authority should be vested in a man, who is even capable of recommending that a taxpayer should be permitted to open the door to the opportunity to claim immense deductions, under the subterfuge of filing amended returns for the purpose of reporting as additional income an inconsequential amount of impounded funds, shows a most dangerous situation.

No further action is taken in this case until January 19, 1925, when the deputy commissioner instructed Mr. Greenidge and the head of the consolidated audit section to assess the deficiency of tax for 1917, unless proper waivers are received before the statute of limitations runs (2830).

Notwithstanding the orders of the commissioner and the deputy commissioner, this case apparently went to audit with depletion determination based upon the amended returns, because on April 18, 1925, L. T. Lohman, head of the consolidated returns division, advises the deputy commissioner that he can not proceed with the audit until the receipt of the engineer's report.

On April 30, 1925, Mr. Thayer, chief of the oil and gas valuation section, sent a memorandum to Mr. L. H. Parker, chief engineer for this committee, which concludes with the following statements (2832):

Inasmuch as the taxpayer has had already three letters, each contradicting the previous one, it is believed to be good policy to take no further action until the offices of the bureau are in accord, to the end that there shall be no further reversals of actions taken. The proper action to be taken is now a matter of discussion between the engineering and audit divisions.

This is not a matter of law, but a matter of interpreting the regulations, and there are good and valid arguments on both sides. Moreover it is purely an interoffice argument over an open case.

Thus, in spite of the fact that the solicitor has twice ruled that the taxpayer was bound by its election to capitalize its development charges, and both the commissioner and the deputy commissioner have formally ordered the case closed on the original returns, the chief of the oil and gas valuation section still considers the question open to be settled by discussion between the engineering and the audit divisions.

The examination of the work in the engineering division of the Income Tax Unit has convinced this committee's staff that nothing is considered settled by Mr. Greenidge until the taxpayer is satisfied, notwithstanding the Commissioner of Internal Revenue, and that this principle governed the work of the oil and gas valuation section under Mr. Thayer.

Had this case involved a claim in abatement, instead of a refund, it would not have gone to the solicitor for approval, and the solicitor's failure to approve would not have brought the case to the attention of the commissioner. Inasmuch as the taxpayer has now filed a claim for a credit against other taxes, the allowance does not now depend upon a refund, requiring the solicitor's approval (2832). The above quotation from Mr. Thayer's memorandum to Mr. Parker shows that the oil and gas section did not regard either the solicitor's rulings or the commissioner's order as binding upon him, and if the chief of the audit division can be induced to pass the claim, it can be slipped by the commissioner without his attention being called to it.

We believe that this case warrants a serious doubt as to whether the work of the engineering division is under the actual control of the Commissioner of Internal Revenue.

Valuation of Metal Mines

(Copper, 1585–1782; silver, 2054)

Investigations made by the metals valuation section of the valutions used as the basis of invested capital and depletion allowances for the copper, silver, and lead mining industries, show that the copper and silver valuations are grossly excessive and that the lead mines are undervalued. The original valuations of 47 copper mines average 330 per cent of what the Income Tax Unit has determined to be proper values for depletion purposes.

The copper properties have been revalued for the taxes of 1919 and subsequent years. Permitting the excessive values to stand for the high tax years of 1917 and 1918 result in a loss of revenue to the Government of aproximately $50,000,000.

The loss of tax, because of the excessive valuations of silver mines, is estimated at $5,000,000 for 1917 and 1918, and an additional loss of tax of about $5,000,000 will result if the present valuations are permitted to stand.

Gross discrimination results from the use of one basis of value for silver produced with copper and another basis for other silver production. There is also gross discrimination against the lead industry, in so far as it is not incident to silver mining.

Copper, Silver, and Lead Mining Closely Related

About 30 per cent of the silver is produced as a by-product of copper mining; 30 per cent is produced with lead, 30 per cent with gold, and the remaining 10 per cent by itself or with zinc. Thus the copper, silver, lead, and zinc mining industries are so closely related, that the application of one sound common basis of valuation to all taxpayers in these four industries is essential to avoid discrimination between these industries and between taxpayers in the same industry.

In 1919 and 1920 tentative valuations, prepared in haste, were placed upon practically all of the properties involved in these industries for invested capital and depletion purposes. The analytic method was used in all of these valuations.

In 1921 an investigation of these values was commenced by the metals valuation section. Gross mathematical errors were found in many of the copper and silver valuations. It was also found that there was no consistency in the prices used in estimating the expected profits, which were the bases of these appraisals. The discount factors applied in reducing expected profits to present value, as of basic date, were also found to be inconsistent, and in many instances inadequate.

EXPECTED PRICES

A most exhaustive study of the trend of metal prices has been made by the metals valuation section. As a result of this study, it was found that the arithmetical average of the monthly average prices for the 10 years preceding March 1, 1913, is the proper basis for the determination of the March 1, 1913, values of metal mines. It was found that this method of pricing is more than fair to the taxpayers, because expected profits, estimated by the use of such prices, when discounted at proper rates give values which closely approximate, but generally slightly exceed, the value of the properties as shown by stock market transactions, actual sales, and other similar evidence of value.

The prices actually used in the metal mine valuations made by the Income Tax Unit prior to June, 1921, are shown in the following table. This table also shows the arithmetical average 10 years prices, found by the metals valuation section to be proper for use in determining March 1, 1913, values; and the ratios of the prices used in making the first valuations to the 10-year average price.

Metal	Prices used in first valuations	Arithmetical average prices Mar. 1, 1903, to Mar. 1, 1913	Ratio, in per cent, of prices used to 10-year average prices
	Cents	*Cents*	
Copper, per pound	16.25	14.93	108.84
Zinc, per pound	5.70	5.57	102.33
Lead, per pound	4.35	4.67	93.15
Silver, per pound	65.00	57.78	113.48

These differences in price may appear small, but the difference in price makes an entirely disproportionate difference in the value. The cost of operation is deducted from the price, thus throwing the whole difference in price into the profit. If the cost of recovering copper is 10 cents per pound and the price is 15 cents, the profit is 5 cents per pound. Increasing the price to 16.25 cents increases the profit from 5 to 6.25 cents, or 25 per cent. The plant cost is deducted from the discounted value of the profits to determine the depletable value of the ore in the ground. Thus, the whole effect of this 25 per cent increase in profit is attributed to the ore, and a difference of 1.25 cents per pound may increase the depletable value of the mine 30 to 35 per cent.

Assuming that the metals valuation section, after careful research, is right in assuming that 10-year average prices are the only sound basis for the determination of 1913 values, the ratios shown in the above table show that the copper and silver interest received excessive valuations, while the lead properties were undervalued. The result is that the copper and silver industries were undertaxed during the years to which these valuations have been the basis of depletion and invested capital, while the lead industry has been overtaxed.

PROTEST BY LEAD INDUSTRY

In 1921, the St. Joseph Lead Co. and the Doe Run Lead Co. protested against this discrimination, and asked for valuations comparable with the copper and silver valuations. The St. Joseph Lead Co. was informed by the bureau that, while errors might have been made in the determination of copper and silver prices, such errors would not be permitted to become the foundation for other errors. These complaints from the lead industry brought about the investigation of the metal valuations above referred to.

DISCOUNT RATES

Incident to the investigation of these early valuations, the metals valuation section also made a thorough and exhaustive study of the discount factors used, and the proper factors to use, in determining metal-mine valuations. To eliminate, as far as possible, the element of guess in selecting discount rates, expected profits, based upon 10-year average prices, were compared with values shown by actual commercial transactions, in cases where such evidence of value was available. By this method discount rates, which would reflect the approximate actual market value of profits, so estimated, were determined, and applied to similar cases, in which there was no means of determining value, except by an analytical appraisal. Tested by these standards, it was found that the discount rates used in the early appraisals were generally inadequate and often inconsistent.

The research work above described was done by or under the direction of Mr. John Alden Grimes, who has been chief of the metals valuation section since March, 1923. The marked ability and exceptional industry of Mr. Grimes, and the remarkable progress he has made toward reducing appraisal work to a sound, scientific basis is worthy of note and commendation. Mr. Grimes's zealous efforts to protect the Government, and persistence in attempting to get mine valuations into line with uniform principles, fair to both the taxpayer and the Government, have made him a most valuable public servant.

HISTORY OF COPPER AND SILVER VALUATIONS

The history of the copper and silver mine valuations shows very clearly that the first valuations were most hurriedly made, and were recognized as being merely tentative, until declared final, as to 1917 and 1918 taxes, by the Commissioner of Internal Revenue in December, 1922.

Prior to June, 1919, the Bureau of Internal Revenue had adopted no system, and had no organization for the valuations of mining property for depletion and invested capital purposes. On June 12, 1919, Mr. L. C. Graton, former secretary of the Copper Producers Association, was appointed as a valuation engineer in charge of the valuation of copper properties. In July, 1919, Mr. J. C. Dick was appointed as a valuation engineer to value the silver and lead mines.

There being no establishment method for the valuation of metal mines, Mr. Graton, assisted by Mr. Dick, undertook to work out a plan or method of procedure. About five months was devoted to this work, and to study of the factors entering into analytical appraisals, such as ratio of profit, interest rates, operating costs and selling prices, before any individual mine valuations were attempted.

In order to facilitate the determination of 1917 tax liabilities, and at the urgent request of the commissioner, work was commenced on the valuation of individual properties about November 20, 1919, and on January 19, 1920, Mr. Graton resigned. During the period of from November 20, 1919 to January 19, 1920, Mr. Graton valued about 60 properties, or more than one per day.

Because of the hurried manner in which this work was done, as well as because of the unsatisfactory character of the data furnished by some of the companies, and to afford the taxpayers an opportunity to be heard, these valuations were labeled "provisional".

Only one or two of the silver mine valuations were marked "provisional," although the same valuation methods were used, as were applied by Mr. Graton in the copper mine valuations.

In December, 1919, the metals valuation section of the natural resources subdivision was organized, with some 18 valuation engineers, and Mr. Dick was appointed chief. Practically all valuations made by the metals valuation section up to February 1, 1920, were called "provisional" valuations, and so marked. At about this date Mr. Dick, chief of the metals valuation section, requested that valuations in the future should not be called "provisional". Up to July, 1921, however, when Mr. A. H. Fay became head of the natural resources subdivision, the same bases of determining metal prices and discounting interest rates as were used in the "provisional" valuations were continued, and an expected selling price of 16.25 cents per pound was used for copper and 65 cents per pound was used for silver.

Hearings upon the copper and silver valuations began February 6, 1920, before Mr. Darnell and Mr. Dick, and proceeded until agreements were effected with all of the large producers. In March, 1920, Mr. Darnell resigned and Mr. Dick became head of the natural resources subdivision (1624).

The fact will be noted, that hearings were afforded these taxpayers, to give them an opportunity to urge that their valuations be increased, and in some instances the first valuations were increased. The possibility of the proposed provisional valuations being too high would not be raised by a taxpayer at such hearings.

INVESTIGATION OF EARLY VALUATIONS

Under Mr. Fay's direction, the metals valuation section began a thorough investigation of the "provisional" valuations in July, 1921. Data was gathered and comparative valuations made, which showed many errors in the methods of calculating values, and that they conformed with but few of the requirements of the regulations. It was found that the provisional valuations frequently determine values several hundred per cent greater than the values which are indicated by any one of the comparative methods specified in the regulations. The provisional valuations were apparently not checked by such comparative methods, or if the appraisal values were compared with such values, no weight was attached to the values determined by the other methods. It developed that a large majority of the big copper companies have reported one value for depletion, and a small fraction of that value for capital stock tax purposes.

In certain cases the taxpayer's own computation of value was discarded and a much higher value substituted. In other cases the taxpayer repeatedly claimed one value in excise tax returns and early income tax returns, and, for later years, was allowed to substitute a much greater value, in direct violation of the regulations. In still other cases, valuations were made upon data and assumptions in direct conflict with the published annual reports of the taxpayers. Enormous paid-in surpluses were allowed the copper companies at organization. Investigation showed that the expected selling price of copper and silver used in the "provisional" valuations was undoubtedly high, and that proper consideration had not been given to the question of interest rates used in discounting to present worth (1625).

GROSS ERRORS IN VALUATION

Exclusive of matters of judgment, there were found to be plain mathematical errors in the majority of the computations made in determining the first or provisional valuations. The principal errors of this character were as follows:

1. Increasing the recoverable metal content per ton of ore without increasing the cost per ton.

A company having a normal concentrating recovery of 75 per cent, plans to add an oil flotation plant, which, it is estimated, will increase the total recovery of metal to 90 per cent. The 90 per cent recovery is used with the operating costs of the existing plant. without additional operating cost for the flotation plant being taken into consideration. Such operating costs are material, as shown by the fact that royalties alone will amount to 8 cents to 15 cents per ton of material treated. Furthermore, the cost of additional plant was not taken into consideration.

Utah and Miami valuations were instances of the above.

2. Using a production cost per pound of copper attained in plant operations, mining a high grade ore, and using the same cost per pound, as the expected cost, with much lower grade ore.

Past operations on 4½ per cent second-class ore, with 90 per cent recovery, later operations on lower grade ore of 3 per cent, giving an

80 per cent recovery with past operating cost of $4.87 per ton used in the appraisal.

$$4.5\times20000=90\times.90=81 \text{ pounds metal per ton } \frac{\$4.87}{81}=\$0.06 \text{ per pound}$$

$$3\times2000=60\times.80=48 \text{ pounds metal per ton } \frac{\$4.87}{48}=\$0.102 \text{ per pound}$$

Increasing in cost per pound $0.042 per pound.

Chino, Wolverine, and Osceola are instances of the above.

3. Assuming that the grade of the ore would remain constant, when a long period of operations had shown that the assay value of the ore was constantly decreasing and might be expected to do so in the future.

In the Butte district the yield in the Anaconda mine dropped, in nine years, from 118.5 pounds of copper per ton of ore treated to 70.2 pounds, a reduction of 40¾ per cent.

Phelps-Dodge Copper Queen mine is an instance of the above.

4. Assuming large additions to plant capacity, with decreased production costs attending increased capacity, and then assuming an average rate of production and an average price for the entire life of the mine.

For instance, a uniform grade and gross proceeds per ton assumed, but also assuming increasing production at successive operating periods, through increased facilities, with corresponding decrease in operating costs. If computation is made for ultimate value, on the basis of averages over the entire life of the property, discounted to present worth, an entirely different and erroneous result will be obtained than if the valuation is made for the successive periods

The Inspiration had an error of this kind.

5. Making no provision for plant requirement when the useful life of the plant is less than the life of the mine.

Reserves assumed 10,000,000,000 pounds.

Total assumed, ultimate plant, $50,000,000.

Actual plant on ground, March 1, 1913, $10,000,000.

Allowing double the rate of 1913 capacity, the total cost would be $20,000,000, leaving $30,000,000 which should be deducted from the present worth of operating profits.

Inspiration and Chino have revisions somewhat similar to the above.

6. Accepting erroneous estimates of the taxpayer without check or correction.

The provisional valuations contained many such erroneous statements in connection with estimates of reserves and value of ores.

Chino and Kennicott cases are instances of the above (1658–1659).

7. Allowing depletion deductions for ore of such low value that it was profitable only in war times, and was not included in the valuation. Thus in one instance a ton of low-profit ore is excluded to each two tons of high-profit ore included in the computation of value. The ore excluded must be removed to permit mining of the commercial ore, and if the price of copper is such that it can be profitably treated, the ore is shipped to the mill instead of to the dump. Perhaps a profit of 25 cents per ton is made and depletion of 50 cents per ton allowed for this ore. Treating this ore has an indirect effect

upon the value of the commercial ore, in that it reduces the plant capacity available for the commercial ore and reduces the present value of that ore (1625).

The same errors were found on investigation in the silver valuations, although not to such a marked degree (2056).

REVALUATION RECOMMENDED

On January 7, 1922, the whole copper and silver situation was laid before the Commissioner of Internal Revenue, and a revaluation was recommended by a memorandum prepared by Mr. Grimes, and forwarded by Mr. A. H. Fay, head of the natural resources subdivision (1635). The copper interests protested and questioned the legal right of the commissioner to revalue. This question was referred to the solicitor, who held, in an unpublished opinion dated April 13, 1922, that the commissioner had authority to redetermine the values fixed by the provisional valuations (1659).

On July 26, 1922, another memorandum, again recommending the revaluation, and more comprehensively reviewing the situation, was prepared for the commissioner by Mr. Grimes (1642).

REVALUATION FOR 1919 AND SUBSEQUENT YEARS ONLY ORDERED

It was not until December 11, 1922, a year after the matter had been formally brought to the commissioner's attention, that action was taken by the commissioner. On December 11, 1922, by an order signed by the commissioner and approved by the Secretary of the Treasury, the revaluation of copper and silver properties was authorized for 1919 and subsequent years (1660). This order has been uniformly construed as definitely approving and making final the first or provisional valuations for 1917 and 1918. (See letter of Secretary of Treasury, p. 3372, and statement of Solicitor Hartson, p. 1774.)

Mr. Gregg stated to the committee that the original copper valuations would not be reopened and the revised values applied to years prior to 1919 (2069).

The work of making revaluations of the copper and silver properties was commenced immediately after the issuance of the commissioner's order of December 11, 1922. The copper valuations, involving more in taxes and containing greater errors, were given precedence. The copper revaluations were practically completed and the revaluation of the silver mines was well under way when both were stopped.

ORDERS STOPPING REVALUATIONS OF SILVER

On April 11, 1924, the commissioner issued the following order (2057, 2058):

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 assumed that no revaluation would become effective until the taxpayer had been given an opportunity to be heard, but the necessity for a change of valuation would not be apparent, in any particular case, and there would be no issue to be heard until a proposed revalution had been made. In view of this situation the metals valuation section was in doubt as to whether the commissioner's order of April 24, 1924, was to be interpreted as prohibiting the application of new valuations to taxes, or was intended to prevent further revaluing for the purposes of determining whether conditions warranted making even proposed changes upon which taxpayers could be heard. This doubt was settled by the following order from Mr. Greenidge (2059).

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.

ORDERS STOPPING REVALUATION OF COPPER

On November 28, 1924, Mr. Greenidge prepared and Mr. Bright signed the following memorandum to the solicitor (1661):

ENGINEERING DIVISION, INCOME TAX UNIT,
November 28, 1924.

Memorandum to Solicitor of Internal Revenue, in re Chile Copper Co. and copper revaluations in general.

Reference is made to the accompanying formal appeal filed by the above-named companies (three paper-bound volumes) in the matter of copper revaluations, special reference being made to memorandum of the Secretary of the Treasury dated December 11, 1922. (Copy attached.)

There are indications that the Bureau's position, as outlined in the above-mentioned memoranda, and actions already taken thereunder, are open to strong contest by taxpayers.

The questions of the right of the Secretary of the Treasury to reopen valuations made by his predecessor in office and to make such revaluations retroactive to January 1, 1919, appear never to have been examined and formally decided by a proper legal authority.

In view of the fact that taxpayers, whose values and taxes have been changed under the above-mentioned memorandum, are voicing almost unanimous objection thereto, it is requested that written opinion be given on the right to reopen valuations and that this opinion be submitted before further time, labor, and money are expended on a matter which promises protracted controversy and litigation for the bureau.

J. C. BRIGHT,
Deputy Commissioner.

It will be noted that this memorandum recited that the authority of the secretary to order the revaluations appears "never to have been examined and formally decided by a proper legal authority," notwithstanding the fact that on April 13, 1922, this very question was decided by the solicitor in this very matter.

On December 5, 1924, Mr. Grimes, chief of the metals valuation section, stated in a memorandum addressed to Mr. Parker, chief engineer for this committee (1661) that—

> At the present time the 1919 returns of seven copper mining companies are held in the metals valuation section under instructions from the head of the engineering division until such time as an answer to the above memorandum is received from the Solicitor of Internal Revenue.
>
> If the legal issues raised by the taxpayers are not conceded or sustained, no difficulty is anticipated by the metals valuation section in the final settlement of the valuation of the copper mines within 10 or 15 per cent of the amounts shown for revaluations on the photostats.
>
> JOHN ALDEN GRIMES,
> *Chief Metals Valuation Section.*

The bringing of this matter before this committee called the solicitor's attention to Mr. Bright's memorandum, and the Solicitor returned the memorandum as a matter already disposed of (1598). This committee was assured that the work of revaluing the copper mines would proceed without further interruption, and such redetermined values would be applied to 1919 and subsequent years' taxes, but that the excessive values would be permitted to stand as the basis of 1917 and 1918 taxes (2069).

RESULTS OF COPPER REVALUATIONS

The second valuation of copper mines covered 47 companies, it being found that a revaluation of the property of the remaining companies was not required. The results determined by these two valuations of these 47 companies varied so widely as to stamp either the first or the second valuation as being unquestionably wrong. Both valuations, however, are being used for tax purposes.

The high values and high depletion units, tentatively determined by the first valuation, are being permitted to stand for the high tax years 1917 and 1918, although such values have been determined to be from 330 to 449 per cent of the proper value to be applied to 1919 and subsequent years. The difference in tax for 1917 and 1918 amounts to about $50,000,000.

The totals of the March 1, 1913, value for depletion purposes of the property of the 47 companies which was revalued as follows:

First valuation	$1,750,024,787
Second valuation	530,217,893
Difference	1,219,806,894

The first valuation, as of March 1, 1913, averages 330 per cent of the second valuation.

As of January 1, 1919, the totals of the first and second valuations of these 47 companies were as follows:

First valuation	$1,456,327,002
Second valuation	323,707,404
Difference	1,132,619,598

The first valuations, as of January 1, 1919, average 449.9 per cent of the second valuations.

In many instances the values determined by the first valuations exceed the values claimed by the taxpayers (1781).

The values claimed for depletion purposes by taxpayers and the amount allowed by the first valuations in several cases are as follows:

	Value claimed by taxpayer	Value allowed by first valuation
Arizona Commercial Mining Co.	$1,500,000	$1,538,000
Calumet & Hecla Mining Co.	46,447,010	50,834,013
Chile Exploration Co.	266,885,982	425,576,000
Inspiration Consolidated Copper Co.	62,214,806	91,654,000
Iron Cap. Copper Co.	2,000,000	2,391,000
Mason Valley Mines Co.	2,161,403	2,969,000
Miami Copper Co.	21,964,026	25,288,000
Mohawk Mining Co.	6,570,000	7,070,822
Mountain Copper Co.	1,416,000	1,829,000
Osceola Construction Mines Co.	12,579,013	12,753,918
Tennessee Copper & Chemical Co.	3,407,400	14,800,000
United Verde Copper Co.	25,000,000	28,426,748
Wolverine Copper Co.	1,576,000	2,176,199

The revaluation of the copper mines not only show that this industry received from three to four and one-half times the depletion to which it was entitled in 1917 and 1918, but that there was marked discrimination between taxpayers in the copper industry. The revaluation of the mines in limestone replacement deposits show that the first valuations average 191.87 per cent of the proper values. The first valuations of vein mines average 307.39 per cent of the proper values, and the first valuations of the porphyry mines average 421.90 per cent of the proper values. Thus, assuming the second valuations to be sound, the porphyry mines have received more than four times the depletion, to which they were entitled, as tax-exempt deductions from income in 1917 and 1918, while the vein mines have only received three times and the limestone mines about twice what they were entitled to.

RESULTS OF REVALUATION OF SILVER MINES

A preliminary examination of the silver valuations disclosed that 54 cases required revaluations. In addition to the matter of expected price, errors similar to but not as great as those characterizing the first copper valuations were found in the silver valuations (2056).

Of the 54 silver revaluations found necessary, 11 had been made on April 11, 1924, when the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, rescinded his order to revalue the silver properties (2057).

The following summary is shown for the 54 cases subject to revision:

Of the 11 valuations completed, the original valuations are $37,517,093. The revised valuations made by the metals valuation section are $23,867,624, a difference of $13,649,169. The original valuations are 157.19 per cent of the revised valuations.

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 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 the 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 de-deductions a tax of $5,127,096 is indicated for 1919 and subsequent years. In some cases it has been found necessaary 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-profits taxes or war-profits taxes, which would amount to a great deal more than those figures if these valuations were made to apply for 1918.

DISCRIMINATION AMONG SILVER PRODUCERS

The silver in copper mines was revalued incident to the revaluation of copper mines. In the copper mine revaluations a basic price of 57.78 cents per pound was placed upon silver. The discontinuance of the revaluation of silver mines thus leaves 70 per cent of the industry, with values based upon silver at 65 cents per pound, and 30 per cent of the industry with values based upon 57.78 per pound.

FURTHER ATTEMPTS TO REOPEN SILVER VALUES

On June 8, 1924, Mr. Grimes addressed another memorandum to the Commissioner, in which he reviewed the status of the silver mine valuation (2086). He called attention to the fact that the silver mine situation had been covered in his memoranda of January 7 and July 25, 1922, and that this subject was not inadvertently included in the commissioner's order of December 11, 1922. This memorandum of June 8, 1924, more specifically brought to the commissioner's attention the erroneous character of the silver mine valuations, as well as the discrimination against producers of silver with copper, and against all other metal industries. In this memorandum Mr. Grimes urged that he be permitted to proceed with the revaluation of silver mines. This memorandum closes with the following statement (2088):

> 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 equitable to the Government and competitor taxpayers because the procedure is so complicated that authority can seldom be obtained.

The statute of limitations barred 1919 taxes assessments on March 15, 1925. On February 25, 1925, the Commissioner of Internal Revenue informed Mr. L. H. Parker, chief engineer for the committee, that he did not recall ever having seen Mr. Grimes' memorandum of June 8, 1924. It was later reported that upon a search of the commissioner's files, this memorandum was located, but without the usual stamp giving the date of its receipt (2075).

Mr. Grimes stated to the committee that he left the memorandum with Mr. Griggs, assistant to Mr. Greenidge, to be forwarded to the Commissioner, on June 8, 1924 (2061).

Mr. Greenidge stated that he took the memorandum to the Commissioner and discussed the subject with him. He stated that he advised the Commissioner to postpone the application of silver revaluations to 1922 and subsequent years.

Mr. Greenidge gave two reasons for postponing the revaluation of silver mines. He stated that the revaluation of silver mines would necessarily involve a revaluation of the lead deposits mined with silver and as the lead industry is now overtaxed enough to offset the undertaxation of silver, the Government would obtain no additional revenue by revaluing silver, and, therefore, he advised against it (2062-2063).

The second reason assigned by Mr. Greenidge for postponing the revaluation of silver mines was that the engineers were too crowded with work to undertake it (2062, 2063).

It will be noted that at the time Mr. Greenidge is advising the commissioner to defer the revaluation of silver mines, because the engineers are too busy to undertake it, Mr. Grimes, upon whose shoulders the burden will fall, is imploring the Commissioner for authority to make the revaluation.

Only about 30 per cent of the silver is produced with lead, and only to this extent is the overvaluation of silver offset by the undervaluation of lead (2065). The silver produced with copper was revalued with the copper. The lead mines of Missouri, Kansas, and Oklahoma produce very little if any silver.

About 40 per cent of the silver is affected by neither the revaluation of copper nor by the overtax of lead. The substance of Mr. Greenidge's recommendation was that 40 per cent of the silver industry should be permitted to continue undertaxed until 1922, because the lead industry in Missouri, Kansas, and Oklahoma, which produces no silver, is overtaxed enough to offset the loss of revenue from silver.

On February 26, 1925, Mr. Grimes stated to the committee that three or four weeks before he had called on the commissioner and had obtained verbal consent to proceed with the revaluation of silver mines (2060). It will be noted that on January 7, 1925, the committee requested information as to what was to be done with reference to silver mine revaluations and Mr. Greenidge stated that this question had not been determined (1133).

The final disposition of the matter of correcting the silver mine valuations is shown by the following order of the commissioner:

SEPTEMBER 25, 1925.

Memorandum for Deputy Commissioner Bright:

On July 13 and 14, 1925, a hearing was held to consider the recommendations of the metals and non-metals valuation section of the engineering division for the revaluation for income tax purposes of silver properties. At this hearing, to which representatives of all the silver producers were invited, extended arguments were made by representatives of the silver industry that no revaluations should be made. An opportunity was also afforded to representatives of the metals and non-metals valuation section to present at that time their reasons for recommending the revaluations. Subsequent to the hearing, the silver producers submitted a brief setting forth their contentions. A copy of this brief, together with a transcript of the proceedings at the hearing, was then given to the metals and nonmetals valuation section for its consideration, and on August 1, 1925, a memorandum was submitted to me by that section setting forth the views of the section on the arguments presented by the silver producers at the hearing and in their printed brief filed subsequent to the hearing. Since that time I have very carefully gone over the transcript of the record of the hearing and the briefs submitted by the silver producers and by the metals and nonmetals valuation section. To assist me in arriving at a decision as to the recommendations made by the engineering division, I have had an independent examination made of some fourteen typical silver properties, and a comparison made in these cases of the original valuations and of the proposed revaluations.

In the various memoranda emanating from the Engineering Division proposing a revaluation of the silver properties, it is contended that the analytical appraisal method used in the original valuations of the silver properties is inconsistent with the method used in the valuation of other similar properties, and that the result is a valuation which is excessive. Particular emphasis is laid in these memoranda upon the future price of silver, 65 cents, used in the original determination of the March 1, 1913, value of silver properties. It is contended that this valuation is excessive and it is recommended that in the revaluations a price of silver of $0.5778 should be used.

The question of the future price of silver which should be used in an analytical appraisal to determine the value of a silver property as of March 1, 1913, is not one which can be determined with mathematical accuracy. In the last analysis the question is purely one of judgment and one on which the judgment of different engineers of equal ability will unquestionably differ. It is the judgment of the present members of the metals and nonmetals valuation section of the engineering division that a silver price of $0.5778 should be used. It was the judgment of the engineers who made the original valuations after careful and exhaustive research into conditions as of March 1, 1913, that a price of 65 cents should be used. I am convinced after careful consideration of the question that a correct result can be reached by the use of a 65-cent price of silver, if the other factors of valuation are relatively correct. Consequently no general revaluation of the silver properties should be made in order to change the 65-cent price of silver, and in those revaluations, which because of previous errors must be made, the silver price should not be changed.

Although in my opinion no general revaluation of silver properties is necessary, it nevertheless appears that errors were made in some of the original valuations. This is necessarily so in view of the haste in which some of the original valuations were made and in view of the limited data then before the department. The use of a 65-cent price of silver, which anticipates a future increase, necessitates the use of a production cost higher than that shown by operations prior to March 1, 1913. Those cases, therefore, in which a 65-cent price of silver was used in the original valuation but where costs were based upon operations prior to March 1, 1913, should be corrected and the costs adjusted on the basis of an anticipated increase over prior costs. Moreover, the examination of the typical silver cases selected indicates that in some cases other gross errors of valuation were made due to lack of time and data, such as incorrect or not substantiated estimates of (1) ore reserves, (2) grade of reserves, (3) recovery, (4) expected plant additions, (5) plant equipment and development on basic date, (6) life of mine, and (7) risk rate. Gross errors in the determination of these or other valuation factors should be corrected. In those cases where revaluation is made to correct such an error in the prior valuation, the corrected value should apply to all years, action on which is not barred by the statute of limitations.

If the metals and nonmetals section determines, in accordance with the conclusions set out above, that an error was made in the original valuation of a silver property and consequently that the property should be revalued, a memorandum should be prepared to the Commissioner of Internal Revenue requesting authority to revalue the property. This memorandum should state in full the reasons and evidence supporting the proposed revaluation, and final action on the matter of the revaluation should be withheld awaiting instructions from the commissioner.

D. M. BLAIR, *Commissioner.*

It will be noted that by this order the commissioner refuses to authorize the revision of expected silver prices, which is the main discriminating feature of these valuations.

The situation ordered to be left undisturbed by the commissioner may be briefly summarized as follows:

Copper is valued on the basis of 10-year average prices.

Lead is valued at 93 per cent of 10-year average prices.

Thirty per cent of the silver is valued at 10-year average prices and 70 per cent is valued at 113.48 per cent of 10-year average prices.

The most serious result is to the morale of those valuation engineers in the Income Tax Unit who have devoted years of close study and intelligent effort to an attempt to reduce valuation methods to a standardized scientific basis, which will eliminate discrimination.

Analytical Appraisal Method Not Suitable For Tax Purposes

It has been shown that differences in the judgment of appraisal engineers, in making valuations by the analytical method, can result in values upon the same property, varying by several hundred per cent. The commissioner's order in the silver cases permits such differences to stand because they are mere differences in judgment.

A comparative analysis of two analytic appraisals of the same property will show that small difference of judgment, which could be honestly entertained by capable engineers, are successively multiplied by each other, until the difference in the final result is so great as to exceed the differences in value which would arise out of mere guessing. To illustrate how differences in estimated basic factors, too small to be attributable to anything except honest differences of opinion, can result in a difference in value so great that it can not be reconciled with common sense, we set up a hypothetical valuation of a copper mine.

In this case, we will assume that two valuations of the same property are being made by two capable engineers whose judgment in estimating basic factors differs slightly, but not enough to impeach the honesty or ability of either engineer.

The hypothetical appraisals of the same property and the per cent of the difference between the lower and higher estimates are as follows:

	First engineer's appraisal	Second engineer's appraisal	Per cent of difference
Reserves in mine in pounds	30,000,000	35,000,000	16⅔
Life of property	12 years	15 years	25
Expected selling price per pound	16 cents	15 cents	6⅔
Estimated operating cost per pound	12 cents	13 cents	8⅓
Profit per pound	4 cents	2 cents	100
Total operating profits	$1,200,000	$700,000	71.4
Discount rate	8 and 4 per cent	10 and 4 per cent	25
Hoskold's present value factor	0.568624	0.444619	28
Present worth plant and ore	$682,348.80	$311,233.30	119
Estimated plant cost	$150,000	$200,000	33⅓
Present value, ores only	$532,348.80	$111,233.30	378.59
Depletion unit	$0.017745	$0.003178	458.37

The estimated basic factors are the pounds of recoverable copper, the life of the property, the expected selling price, the estimated operating cost, the plant cost and the discount rate.

The greatest per cent of difference in any of these factors is the plant cost which is 33⅓ per cent, yet the difference in the depletion unit is 458.37 per cent, and it may be reasonably assumed, that two intelligent mining engineers could guess closer than this without making an appraisal.

The difference in expected price is only 6⅔ per cent and the difference in operating cost is only 8⅓ per cent, yet the difference in expected profit per pound is 100 per cent. This difference in expected profit is reducted to 71.4 per cent in the total, because of the lower estimate of reserves in the appraisal showing the higher estimate of profit per pound.

The difference in the expected rate of return on the investment is 25 per cent, which is increased to a 28 per cent by the 25 per cent difference in estimated life. The 71.4 per cent difference in total expected profit, is increased to a difference of 119 per cent in present value of plant and ore, by the difference of 28 per cent in the present value factor. The deduction of the plant throws the entire difference in the present value of plant and ore into the value of ore.

Had there been the same estimates of plant cost, by both engineers, of $200,000, the value of ore, according to the first engineer, would be $482,348.80 and, according to the second engineer, $111,233.30, a difference in ore value of $371,115.50. Thus, by deducting the same plant cost from both, the difference of 119 per cent, in value of plant and ore, is increased to a difference of 334 per cent in the value of the ore. In the hypothetical case, we have assumed a 33⅓ per cent difference in estimated plant cost, which increases the difference in ore value to 378.59 per cent.

When the different ore values are divided by the different reserves estimated, the difference of 16⅔ per cent in reserves increases the difference in ore value of 378.59 per cent to a difference in depletion units of 458.37 per cent.

None of the percentages of difference in basic factors which we have assumed in this case exceed the difference in the same basic factors which occurred in some of the actual copper valuations, and the difference in selling price assumed of 6⅔ per cent is only half the 14 per cent difference in the prices used in the silver valuations ordered by the commissioner to remain uncorrected.

It is manifest that permitting deductions from income, based upon so elastic a method of valuation, which leaves so much to the uncontrollable judgment of appraisal engineers, is practically delegating the power of taxation to the employees of the Income Tax Unit. While methods for determining estimated factors may, to some extent, be standardized, standardization can not be carried to such an extent as to insure uniformity of treatment among industries, nor among taxpayers in the same industry, and the attempts to standardize such factors do not meet with encouragement from the Commissioner of Internal Revenue.

That such appraisals, involving to the extent they do, the uncontrollable judgment of appraisal engineers, are a source of endless controversy between the Income Tax Unit and taxpayers, is not only a fact, but is not at all surprising.

Any just method of determining depletion which does not involve the necessity of appraising the value of property by analytical appraisals will not only stop manifest gross discrimination but eliminate from the administration of the law one of the most fruitful sources of controversy, facilitate the determination of tax liability, and eliminate a great burden of expense to both the Government and the taxpayers.

Dr. Thomas S. Adams, of Yale University, and for a long time connected with the Treasury Department as an expert on taxation, says:

> I think that no one thing so conduces to delay and complexities of the tax laws as the necessity for valuation (269).
>
> I think it may be possible, and I hope that the department, some representatives of which are present, will bestir themselves to make suggestions to get away from * * * problems of valuation, the solution of which problems means the exercises of judgment and differences of opinion, mistakes, and delay. If there is any human way of getting away from that, the Government of the United States ought to get away from it (270).

Mr. Gregg states:

> If something could be done in the law to do away with the necessity for valuing mineral properties for the purpose of determining depletion, it would be the biggest help of anything that has ever been done to the Bureau of Internal Revenue. If that could be done it would take a tremendous burden off of us. It would help the administration of the bureau tremendously, and would certainly be more accurate than the present system. If Congress continues to recognize depletion, I have never been able to work out anything that would do away with the necessity for making these valuations (2776-2767).

PROPOSED SUBSTITUTE FOR ANALYTIC APPRAISAL

A method of determining depletion and depreciation allowances in certain cases by discounting actual profits annually as earned is proposed for the committee's consideration and will be fully described.

The economic soundness of measuring the value of property for depletion purposes by capitalizing earnings is not involved in this comparison of the method proposed with the method now in use. Every method of determining the value of property by capitalizing future profits is based upon the economic theory that the value of property is measurable by the profit which can be derived from its operation. Both the method in use and the method proposed are based upon this theory. The method proposed is simply a different method of reaching the same result, and is based upon the same economic principle as the method in use.

It is conceded that there are classes of property, such as gold, copper, silver, lead, and zinc mines, in which there is not sufficient similarity between different individual properties to permit valuations on a comparative sales basis. There appears to be no method other than by capitalizing expected profits to determine the value to be depleted in such cases.

The value derived by capitalizing earnings represents the utility value to an owner who is willing to accept an assumed rate of return. Such value is greater than market value if a purchaser can not be found who is willing to buy at that price. It is less than the market value if purchasers are willing to pay more. The only justification for the determination of value by capitalizing earnings is that, in some cases, there is no other method for measurement of depletion allowances, and the use of any method based upon earnings should be strictly confined to such cases.

APPRAISAL UNNECESSARY

It is not necessary to determine the total value to be depleted to determine the depletion allowances to be deducted from income each year. By a process of discounting the actual profits of each year, as such profits are determined by actual operations, allowances for depletion and depreciation for each current year can be determined. The proposed annual method of discounting actual profits will be later described in detail and compared with the method in use. This method will not determine in advance a total value to be depleted, but when the life of the property is terminated by the exhaustion of the deposit, the total deductions for all years will exactly equal the total deductions, which would be allowed upon a theoretically perfect analytical appraisal.

By this method of annual discounting of actual operating profits, all estimating is eliminated, except the determination of the discount rates. The same result, in aggregate depletion and depreciation allowances, is obtained by the proposed method as would be obtained by an appraisal in which the recoverable reserves in the ground, the life of the property, and the expected profits are estimated with 100 per cent accuracy. Furthermore, this method returns as tax-free depletion and depreciation, the actual economic value, as of basic date, of each year's profits, while the present method returns the average economic value of the profits of all years.

ADVANTAGES CLAIMED FOR ANNUAL DISCOUNT METHOD

1. All estimating of the expected profits, and the life over which expected profits are to be discounted, is eliminated.

This estimating must be done by many different engineers employed by the taxpayers and by the income tax unit. No two engineers appraising the same property would ever reach the same result without conferring and compromising on matters of judgment.

The results obtained in the copper and silver cases varying on the average over 300 per cent show conclusively that in the use of any method of valuing, based to so great an extent upon individual judgment, gross discrimination between industries and between taxpayers in the same industry is the inevitable result. Such discrimination, in so far as it is based upon varying judgment in estimating life and expected profits, is eliminated by the proposed method.

2. Reducing the profits to be discounted to one standard, i. e., actual profits, permits a standardization of discount rates which is not possible where estimated profits are the basis of value.

Many cases reviewed in this report show such extravagant estimates of expected profits to be recovered within the estimated life, that it required equally extravagant discount rates to discount such estimates of profits to the actual value of the property, as shown by actual sales, or other similar evidence of value.

A method of standardizing discount rates carefully worked out by Mr. Grimes has been described. Standardized discount rates will not reflect standardized values unless the estimates of life and profits are also standardized. Estimates of life and profits, being so wholly dependent upon the individual judgment of the appraisal engineer, can not be standardized.

The result is that standardized discount rates can not be applied to estimates, because different discount rates must be applied to conservative estimates than would be applied to extravagant estimates.

The use of actual profits and actual life elimates this difficulty and permits the standardization of discount rates.

3. The use of actual profits and standardized discount rates, which can be determined by statistical investigation, and published by the Income Tax Unit, reduces the determination of depletion and depreciation of mines to a mere matter of mathematical calculating, the accuracy of which is subject to absolute check, and which can be done by any intelligent clerk. This eliminates the necessity for the employment of high-priced appraisal engineers by both the Government and by the taxpayers.

4. The use of actual profits and standardized discount rates will eliminate one of the principal grounds of controversy between taxpayers and the Government and one of the principal causes of delay in finally determining taxes by the Income Tax Unit. It will also eliminate the expensive and prolonged litigation which will probably result, if the values fair to the Govenment are fixed under the present system.

5. The method of annual discounting proposed will return taxfree, as depletion and depreciation, the actual economic value, as of basic date, of the capital consumed each year, instead of the average economic value of such capital, which is returned by the method in use. It will be later shown that the present method attributes to every pound of metal the same profit, and to every dollar of profit the same value as of basic date, regardless of whether that profit is recovered during the first year or during the tenth year after the basic date.

6. The proposed method insures the payment of a tax for every year showing an operating profit. The depletion and depreciation always being less than 100 per cent of the operating income, there will be some taxable income in every year showing an operating income. Under the present method the depletion and depreciation resulting from high valuations, allowances may exceed the operating income, and a loss is carried forward in the following year. This is what accounts for many companies in natural-resource industries reporting no taxable income in years when earnings available for dividends are shown.

ACTUAL FACTORS EQUAL TO FACTORS IN PERFECT ESTIMATE

In making a valuation by the analytic or present value method the following basic factors are estimated.

1. The number of recoverable units in the deposit.
2. The expected price per unit.
3. The estimated future cost of production per unit.
4. The estimated period required to recover the estimated units in the deposit.
5. The estimated plant cost.
6. The rate of return, or interest rate, upon the investment, required to attract capital to invest in the property.

Regulations 65 (Art. 205) provides:

(d) In the application of factors derived from past experience full allowance should be made for probable future variations in the rate of exhaustion, quality, or grade of mineral, percentage of recovery, costs of production, and selling price of the product marketed during the expected operating life of the mineral deposit.

(e) The number of units of mineral recoverable in marketable form multiplied by the estimated operating cost per unit gives the total expected operating profit. The value of each mineral deposit is then the total expected operating profit from that deposit reduced to a present value as of basic date at the rate of interest commensurate with the risk for the operating life, and further reduced by the value at the basic date of the depreciable assets and of the capital additions, if any, necessary to realize the profits.

From the above quoted regulations, it is clear that the appraiser is expected to look into the future, and anticipate, so far as conditions as of basic date will permit, the profit which will be realized from the property during its entire life, the period required for the realization of such profit, and the cost of such plant and other capital additions as may be required. The accuracy of any analytic appraisal depends upon how closely the estimates agree with the actual profits subsequently recovered, the actual time required for recovery, and the actual plant cost. If an appraiser could look into the future and determine the actual profits, the actual periods of deferred recovery, and the actual plant costs, he could, as to these basic factors, make a perfect appraisal.

Thus, if actual profits, discounted from the time they are actually recovered, to the basic date, and actual plant costs are used, in the place of estimates, these basic factors will be identical with the same factors in a perfect appraisal.

CAPITAL CONSUMED DURING LIFE EQUAL TO TOTAL OF CAPITAL CONSUMED EACH YEAR

The allowance of depletion and depreciation, as tax-free deductions from income is predicated upon the theory, that, in converting the mineral in the ground into operating profit, capital which existed on the basic date is consumed. The total depletion and depreciation properly allowable, during the life of the property, is the present value of the whole property, as of basic date.

The whole capital, consumed during the life of the mine, must equal the total of the capital consumed during each of the several years of life. It therefore follows, that a proper allowance for depletion and depreciation, for any year, is the value, as of basic date, of that portion of the capital which is consumed in producing the operating income of that particular year. If the total capital consumed during life is equal to the discounted value of the total operating profits, recoverable during life, the capital, consumed during any year, must be equal to the discounted value of the operating profits of that year.

The economic soundness of these propositions can not be questioned, and it will now be demonstrated, that the value, as of basic date, of the property consumed during each year, can be determined by a mathematical process, which will give present values, derivable from each year's actual operating profits, which will equal, in the aggregate, the present value of the whole property, which would be determined by a theoretically perfect appraisal.

DISCOUNTING THROUGH HOSKOLD'S TABLE

In discounting expected profits to present value, as of basic date, Hoskold's tables are generally used by the Income Tax Unit valuation engineers. These tables give the present value of one dollar, accumulated in equal annual installments, to the end of any given year, at different given rates of interest. The present values given by these tables can be most simply explained by illustration.

Assume that the profits to be derived from a mine are estimated to be $1,000,000, the life of the mine is estimated to be 10 years, and 10 per cent per annum is estimated to be the rate of return, which is necessary to induce capital to invest in the property. The use of Hoskold's tables assumes that the $1,000,000 will be recovered in ten equal installments of $100,000 each.

At a 10 per cent profit and 4 per cent sinking fund rate, Hoskold's tables gives the present value of one dollar, recoverable in 10 equal annual installments as $0.545580691. The present value of $1,000,000, recoverable in 10 equal annual installments, assuming a 10 per cent rate of profit is expected, is, according to Hoskold's tables, $545,580.69. In arriving at this value it is assumed, that the investor will withdraw profits of 10 per cent of the investment, and will pay the balance of the $100,000 annual operating profit into a sinking fund, which will be reinvested at 4 per cent until the end of the 10-year life. These sinking fund payments, plus 4 per cent compounded annually, will equal the present value, or $545,580.69, at the end of the ten year period. Thus, if the investor pays $545,580.69 for this property, and actually realizes operating profits of $100,000 per year, he can withdraw $54,558.069, each year, as a return on his investment. This equals 10 per cent of the investment. There will be left, out of the $100,000 annual operating profit, $45,441.931 to set aside as a sinking fund. These sinking fund payments, in 10 years, will aggregate $454,419.31, and the interest on the amounts paid into the sinking fund, at 4 per cent compounded annually, will equal $91,161.38. Thus the sinking fund installments, plus sinking fund interest, will equal the investment of $545,580.69.

The distribution of the $1,000,000 expected profit is shown by the following table:

Year	Annual profit	Annual interest payment at 10 per cent	Annual installment to sinking fund	Compound interest on sinking fund at 4 per cent
1	$100,000	$54,558.069	$45,441.931	
2	100,000	54,558.069	45,441.931	$1,817.677
3	100,000	54,558.069	45,441.931	3,708.062
4	100,000	54,558.069	45,441.931	5,674.061
5	100,000	54,558.069	45,441.931	7,718.701
6	100,000	54,558.069	45,441.931	9,845.126
7	100,000	54,558.069	45,441.931	12,056.609
8	100,000	54,558.069	45,441.931	14,356.550
9	100,000	54,558.069	45,441.931	16,748.489
10	100,000	54,558.069	45,441.931	19,236.106
Total	1,000,000	545,580.690	454,419.310	91,161.381

The payments into sinking fund	$454,419.310
Plus the compound interest thereon	91,161.381
Equals the present value as required	545,580.691

Assuming that the profit of $1,000,000 was based upon assumed reserves of 1,000,000 tons of ore, the unit method of distribution of depletion would give a depletion unit of 54.558069 cents per ton. The recovery of $100,000 of operating profit would require the recovery of 100,000 tons of ore each year for 10 years, and the depletion allowance would be $54,558.07 per year.

HOSKOLD'S TABLES NOT BASED ON EQUAL ANNUAL VALUES

While the values given by Hoskold's tables are such that the assumed return can be paid annually, and the investment amortized by equal annual installments into a sinking fund, Hoskold does not attribute equal value to each year's earnings. Hoskold's tables of value are based upon the economic fact that the present value of money to be recovered in the future decreases as the period of deferred recovery increased. At 10 per cent and 4 per cent Hoskold's tables give the value of $5 accumulated in equal annual installments of $1 each for five years as $3.51 plus, and the value of $6 accumulated in equal installments of $1 each for six years as $3.98 plus, The present value of the $1 recoverable in the sixth year can be derived by subtracting the present value of the $5 accumulated in five years from the value of $6 accumulated in six years. Thus Hoskold attributes a present value of $0.47 plus to a dollar recoverable six years after basic date. By the above-described method the present value attributed by Hoskold's tables to $1 recoverable in any future year can be derived.

The following table shows in column 2, opposite each year after the basic date, the value of $1 accumulated in equal annual installments from basic date to the end of the year designated at 10 per cent and 4 per cent. These figures are taken directly from Hoskold's tables.

Column 3 shows the value of $1 per annum accumulated from basic date to the end of the year designated in column 1. Thus opposite the fifth year we find $3.51 plus as the value at the beginning of the first year of $5 to be accumulated at the rate of $1 per year for five years.

Column 4 shows the present value as of basic date of $1 to be received during each year designated after the basic date. These figures are derived from Hoskold's tables by the method above described, and represent the different present values attributed by Hoskold's tables to profits, the realization of which is deferred for the various periods designated.

(1) Period of deferred realization after basic date	(2) Hoskold's 10 per cent and 4 per cent table—Present value of $1 accumulated in equal installments	(3) Present value of $1 per annum accumulated for period designated, 10 per cent and 4 per cent—Hoskold	(4) Present value of $1 receivable in year designated, derived from Hoskold's 10 per cent and 4 per cent table
1st year	$0.909091	$0.909091	$0.909091
Second year	.847176	1.694352	.785261
Third year	.792993	2.378978	.684626
Fourth year	.745178	2.980714	.601736
Fifth year	.702675	3.513369	.532654
Sixth year	.664641	3.987847	.474478
Seventh year	.630410	4.412875	.425029
Eighth year	.599440	4.495523	.382647
Ninth year	.571286	5.141573	.346050
Tenth year	.545581	5.455807	.314234

Reverting to the hypothetical case of the mine which was assumed to contain 1,000,000 tons of ore recoverable in 10 years at an operating profit of $1 per ton, we can determine the present value of such profits for any year without reference to the reserves, the life, or the assumed estimated profit by multiplying the actual operating profits earned each year by the value of $1, as shown by column 4 of the above table, for the years of deferred recovery since the basic date.

Thus if the basic date is 1913 and the present value of profits recovered in 1923 is desired, the value of $1 in the tenth year is 0.314234, and if $100,000 of profits are recovered in 1923 the present value of such profits on January 1, 1913, is $31,423.40. This one calculation is all that is required to determine the depletion and depreciation allowance for any year.

That the aggregate of the present values of each year's earnings separately discounted by this method will equal the present value of the aggregate earnings discounted through Hoskold's tables, provided the earnings are recovered in equal annual installments, as the use of Hoskold's table assumes, is shown by the following table. This table also shows the distribution of depletion according to the bureau method.

Period of deferred realization after basic date	Operating profits	Present value as of basic date of operating earnings recovered during year	Distribution of present value as depletion by bureau method
First year	$100,000.00	$90,909.09	$54,558.06
Second year	100,000.00	78,526.12	54,558.07
Third year	100,000.00	68,462.60	54,558.07
Fourth year	100,000.00	60,173.62	54,558.07
Fifth year	100,000.00	53,265.44	54,558.07
Sixth year	100,000.00	47,447.79	54,558.07
Seventh year	100,000.00	42,502.89	54,558.07
Eighth year	100,000.00	38,264.74	54,558.07
Ninth year	100,000.00	34,605.05	54,558.07
Tenth year	100,000.00	31,423.35	54,558.07
Total	1,000,000.00	545,580.69	545,580.69

Present value per hoskold at 10 and 4 per cent=$545,580.69.

As has been shown, according to Hoskold's tables, the present value of $1,000,000 recoverable in 10 equal annual installments at 10 per cent and 4 per cent is $545,580.69. By dividing this value by the estimated tonnage, which was assumed to be 1,000,000 tons, the bureau method attributes the same profit to every ton of ore recovered. By using Hoskold's tables of present value of money recoverable in equal annual installments, the bureau method assumes that the tonnage mined each year will be equal.

In the above table we have assumed that all of these assumptions are in accordance with the facts. We assume that $1,000,000 is actually recovered in profits arising out of the mining of 100,000 tons of ore a year, yet the above table shows the annual deductions for depletion under the method in use do not represent the economic value attributed to the ore mined each year by the very tables from which the present value was derived. The depletion allowances during the first four years are less than the value as of basic date of the ore mined during those years, and the depletion allowances during the last six years are in excess of the value as of basic date of the ore mined.

ANNUAL DISCOUNTING INVOLVES NO ASSUMPTIONS

The proposed method of discounting annual profits involves no assumptions. After making proper deductions from operating profits to cover the use of working capital, the value as of basic date of the operating profits actually recovered during the year is allowed as the deduction for depletion and depreciation. Thus, the difference in the economic value of profits recovered in different years due to the difference in the period of deferred recovery is recognized and the inevitable variation in profits from year to year is provided for.

ANY SOUND METHOD OF DISCOUNTING MAY BE USED

In discussing the proposed method of annual discounting of actual profits, it has been compared with results obtained by using Hoskold's tables, because these tables are in use in the Bureau of Internal Revenue and are used generally by appraisal engineers. This comparison has been made to show that the same results in value are obtained by this method as would be determined by a theoretically perfect appraisal if all assumptions are verified by subsequent operations and that the distribution of value as depletion and depreciation by the annual method is economically sound while the unit method in use is not.

It is not necessary, however, to use Hoskold's tables, as any method of discounting aggregate profits can be applied to actual annual profits. It must be borne in mind, however, that if discounting is done by straight compounding of interest a higher discount rate must be used than would be used if the discount is applied through Hoskold's tables.

PERCENTAGE METHOD

If the fact that the per cent of operating profits allowable as depletion and depreciation under the annual discount method proposed is graduated to conform to the difference in the economic value as of basic date of each year's profits is an objection to the use of such plan for taxation purposes, the analytic appraisal can be dispensed with by the use of what may be called the percentage method of depletion and depreciation.

The percentage method requires an estimate of the life of the property which is not required by the annual discount method. With the discount rate assumed and the life of the property estimated, the present value factor is shown by Hoskold's tables. In an analytic appraisal the ratio of the present value to be returned as depletion and depreciation to the estimated total operating profit is always expressed by the present-value factor. As actual operating profits earned equal perfectly estimated profits, the present value factor shown by Hoskold's tables can be applied directly to actual operating profits as earned. If the actual profits equal the estimated profits and the life has been accurately estimated, the result of the direct application of the present value factor to actual profits will be equal to the results of a theoretically perfect appraisal. Thus the estimating can be reduced to the selection of the discount rate and the determination of life and the estimates of reserves and profits can be eliminated.

The percentage method differs from the annual discount method in that the percentage method requires an estimate of life, while the annual discount method requires no estimate of life, and the percentage method returns the same per cent of operating earnings as depletion and depreciation each year, while the annual discount method returns a graduated percentage. The graduated percentage returned by the annual discount method represents the economic present value of the capital consumed in producing each year's operating profits, while the flat percentage of operating profits returned by the percentage method represents the average economic value of the operating profits of all years.

The necessity of estimating life in the use of the percentage method is a serious objection to this method. Estimating life involves the necessity of estimating reserves, future plant capacity, and future demand. The Freeport Texas Sulphur Co. and the American Petroleum Co. of California cases illustrate how the life of property can be underestimated by overestimating annual production. An underestimate of life results in raising the present value factor for any given discount rate. If the percentage method is used the allowance for depletion and depreciation should stop when the end of the estimated life is reached.

Comparison of depletion allowances on a 10-year, 20-year, and 30-year property by bureau's method and annual method, using Hoskold's 10 per cent and 4 per cent tables

[Explanation: Annual production=100,000 tons; net operating profit per ton=$1; net annual profit per ton=100,000 × $1=$100,000]

Year	Annual operating profit	Annual discount factor at 10 per cent and 4 per cent	Value as of basic date=depletion annual method	Hoskold's 10 and 4 factor for 30 years=bureau's depletion unit	Bureau's allowance for depletion
First	$100,000	0.90909091	$90,909.091	0.282893196	$28,289.320
Second	100,000	.78526125	78,526.125		28,289.320
Third	100,000	.68462601	68,462.601		28,289.320
Fourth	100,000	.60173620	60,173.620		28,289.320
Fifth	100,000	.53265436	53,265.436		28,289.320
Sixth	100,000	.47447781	47,447.781		28,289.320
Seventh	100,000	.42502888	42,502.888		28,289.320
Eighth	100,000	.38264745	38,264.745		28,289.320
Ninth	100,000	.34605048	34,605.048		28,289.320
Tenth	100,000	.31423350	31,423.350		28,289.320
Totals for 10 years	1,000,000		545,580.691		282,893.200
Eleventh	100,000	.28640105	28,640.105	.282893196	28,289.320
Twelfth	100,000	.26191666	26,191.666		28,289.320
Thirteenth	100,000	.24026605	24,026.605		28,289.320
Fourteenth	100,000	.22103016	22,103.016		28,289.320
Fifteenth	100,000	.20386462	20,386.462		28,289.320
Sixteenth	100,000	.18848444	18,848.444		28,289.320
Seventeenth	100,000	.17465200	17,465.200		28,289.320
Eighteenth	100,000	.16216804	16,216.804		28,289.320
Nineteenth	100,000	.15086437	15,086.437		28,289.320
Twentieth	100,000	.14059823	14,059.823		28,289.320
Totals for second 10 years	1,000,000		203,024.562		282,893.200
Totals for 20 years	2,000,000		748,605.253		565,786.400
Twenty-first	100,000	.13124787	$13,124.787	.282893196	28,289.320
Twenty-second	100,000	.12270890	12,270.890		28,289.320
Twenty-third	100,000	.11489140	11,489.140		28,289.320
Twenty-fourth	100,000	.10771759	10,771.759		28,289.320
Twenty-fifth	100,000	.10111990	10,111.990		28,289.320
Twenty-sixth	100,000	.09503952	9,503.952		28,289.320
Twenty-seventh	100,000	.08942665	8,942.665		28,289.320
Twenty-eighth	100-000	.08422812	8,422.812		28,289.320
Twenty-ninth	100,000	.07941615	7,941.615		28,289.320
Thirtieth	100,000	.07494735	7,494.735		28,289.320
Totals for third 10 years	1,000,000		100,074.345		282,893.200
Totals for 30 years	3,000,000		848,679.598		848,679.600

UNIT AND PERCENTAGE METHODS RESULT IN DISCRIMINATION AMONG TAXPAYERS IN SAME INDUSTRY

Both the unit method now in use and the percentage method above described result in discrimination among taxpayers in the same industry. This discrimination is illustrated by the accompanying table.

Assume the cases of A, B, and C, three taxpayers in the same industry. Each taxpayer owned his deposit on March 1, 1913, and each is operating in 1923. A's deposit had 10 years' supply on March 1, 1913. On that date B had 20 years' supply and C had 30 years' supply. The fact is recognized that the differences in the lives of these properties is a factor to be considered in determining the discount rate, but we will assume that the characters of these three deposits are such that the same discount factors are properly applicable to the three properties. It is also assumed that the operating earnings of each property is $100,000 per year.

As each of these properties is producing the same amount of operating profits, the period of deferred recovery of the profits is in each case the same until the shorter lived properties are exhausted, and as these operating profits are discounted at the same rate it would seem that A, B, and C should receive the same allowance for depletion.

Assuming each property earns an operating profit of $1 per ton, the depletion allowance to A for 1923, under either the unit or percentage method, will be $54,558.07, to B $37,430.26, and to C $28,289.32.

Under the annual discount method proposed each would receive the same allowance of $31,423.35.

A's property is estimated to produce $1,000,000 of income in 10 years; B's property and C's property also produce $1,000,000 each during the same period. B's property will also produce $1,000,000 during the 10 years after the exhaustion of A's property. The $1,000,000 produced during the first 10 years has a present value of $545,580.69 in both cases. The present value of the second $1,000,000 recovered by B in the eleventh to the twentieth years, is only $203,024.56. A's allowance is based on a 10-year average of 54 plus per cent, while B's allowance is based on a 20-year average of 37.4 per cent and C's allowance on a 30-year average of 28.29 per cent. Thus, all other factors being equal, the owner of a long-life property will receive a lower depletion allowance than the owner of a short-life property under either the unit or percentage methods, while they will both receive the same allowance under the annual discount method.

DEPLETION AND DEPRECIATION SHOULD BE COVERED BY ONE ALLOWANCE

In all cases when the value to be depleted is based upon the present value of earnings there would be but one allowance covering both depletion and depreciation.

The capital consumed in converting an ore deposit into operating profits is the combined value as of basic date of the depreciable plant and the depletable deposit. The useful value of the plant is dependent upon the deposit. The actual physical life of a particular plant may be longer than the life of the deposit. If the life of the deposit exceeds the physical life of the plant, another plant must be built. If the physical life of the plant exceeds the life of the deposit, the useful life of the plant terminates with the life of the deposit.

The present value of the property, determined by any method of discounting profits, includes the value of both the depreciable plant and the depletable deposit, and any separation of these values involves estimating. By the present method of determining depletable value, by an analytical appraisal, the estimated plant cost is deducted from the present value of the estimated expected profits, and the residue is the value to be depleted. If the estimated life of the deposit exceeds the estimated life of the plant, the estimated cost of one or more additional plants to be erected in the future must be deducted. The failure to consider future plant costs constituted some of the most serious errors in the copper valuations. An underestimate of plant cost results in an excessive value to be depleted.

Depletion is determined by the engineering division, and depreciation allowances are passed upon by the auditors. There may be absolutely no relation between the depletion allowance by the engineers and the depreciation allowance by the auditors, although the amount of depletable value, being the residue after deducting depreciable value from the present value of operating profits, is dependent entirely upon the amount of depreciable value deducted.

Mr. Grimes, chief of the metals valuation section of the income tax unit, stated to the committee that depletion and depreciation should be covered by one allowance. (1686.)

If depletion and depreciation are covered by one allowance, that allowance can be determined for any year by either the annual discount method proposed or by the percentage method by applying the present value factor directly to operating profits actually earned after operating profits have been reduced by the expected profits on operating capital.

COMPUTING PROFIT ON SALE

In case of the sale of a mine upon which depletion is computed by the annual discount method proposed the price received may be treated as operating profit, which, discounted to basic date, gives the income to be taxed. There can be no such thing as a loss arising out of the sale of a mine the value of which is based on profits. The 1913 value being predicated upon profits, any apparent loss is due to overvaluation as of 1913. If the price received is less than the actual cost plus depletion and depreciation, the cost becomes the basis of determining loss and 1913 value is immaterial.

STANDARDIZING DISCOUNT RATES

As has been pointed out, the total lack of any means of determining the relationship between the estimated profits used as the basis of an analytic appraisal and the actual profits which will be derived from the business makes it impossible to standardize discount rates for use in analytic appraisals. If the appraisal engineer feels that he has estimated profits on a very liberal basis, he can overcome that liberality by the use of a liberal discount rate. If he feels that his estimate of profits is low, he can offset this low estimate by a low discount rate.

The cases cited in this report indicate a very liberal policy in estimating profits and a very conservative policy in discounting.

The use of actual profits as the basis of value permits the absolute standardization of discount rates. Such standardized discount rates should be required by law to be based upon a most careful and exhaustive statistical investigation. The material for such purpose is already in the possession of the Income Tax Unit.

It may be assumed that in purchasing a natural resource for exploitation the purchaser assumes that he will recover back his investment and earn a return upon it equal to at least the average of what successful operators of such property are earning. The Income Tax Unit has the evidence of cash sales in the reports of income from profits and the deductions from losses. It also has the income returned as derived from such property. Valuations by the use of discount factors derived from such information may be checked with actual sales, and by using both means standardized discount factors far different industries can be derived and published.

A comparison of the discount rates applied to the valuation of property in different natural resource industries, with the earnings upon invested capital of representative companies in those industries, discloses a wide difference, and at least indicates that the discount rates in use are about one-half of what they should be.

The statistics of actual earnings were compiled from the records of the special assessment section. These companies were selected by the committee staff as representative of the industries because they had been selected by the special assessment section as representative comparatives for special assessment purposes.

Industry	Discount rates used by bureau for valuation purposes	Per cent of net income to invested capital representative companies
Copper mining	7 to 10 per cent	14.0
Iron mining	do	16.0
Oil production	10 per cent midyear	19.7
Natural-gas production		19.7
Sand and gravel	8 to 10 per cent	21.0
Salt manufacturing	do	23.6

It is not contended that the rates of profit shown above should be adopted as discount rates, but it is contended that these profit rates of companies selected by the bureau as representative are so far out of line with the rates in use that the necessity for a most thorough and careful statistical investigation is clearly shown.

It is not contended that the discounting of actual profits by standardized published discount rates for the purpose of determining annual allowances for depletion and depreciation will bring 100 per cent perfect results, but it is maintained that the results of such a method will equal 100 per cent perfect appraisals without the discrimination due to the varying judgment of appraisers and the controversy, expense, and delay necessarily incident to appraisals.

AMORTIZATION OF WAR FACILITIES

The allowance of tax-free deductions from income for the amortization of the war facilities of manufacturers and miners is a subject which demands the immediate attention of Congress.

The magnitude of this subject is shown by the following figures:

	Number of claims	Total amount
Amortization allowances to Apr. 30, 1925	3,334	$596,934,813.26
Amortization claims pending but not acted upon on Apr. 25, 1925	178	75,171,169.87
Total	3,512	672,105,983.13

Notwithstanding the tremendous amounts involved, the regulations have contained no adequate statement of the principles to be observed in determining amortization allowances. No ruling or instructions for the guidance of either the engineers of the income tax unit or taxpayers were published until after the expiration of the time fixed by law for the redetermination of claims. The only published ruling of the solicitor on this subject prior to October, 1925, has been completely ignored, and there has been a total lack of supervision over the work of the engineers of the income tax unit engaged in passing on amortization claims.

The failure to observe any well-defined principles as to either the kind of property the cost of which is amortizable or in measuring the allowance has resulted in the grossest kind of discrimination among taxpayers.

The improper amortization allowances are principally upon facilities which have been retained in post-war use by taxpayers, and in many cases such allowances are in addition to allowances covering all loss due to reduced post-war replacement value.

These allowances are predicated upon the assumption that all manufacturing capacity above the average requirements of 1921, 1922, and 1923, but required to meet the irregularity of month to month and year to year demand, required to participate in the profits of the years when demand is greatest and profits are highest, required to replace older facilities as they wear out, and required to meet the expansion of a growing business, represents a total permanent capital loss properly attributable to the war years.

In many cases amortization has been allowed on the theory that manufacturing capacity created by war expenditures constituted a useless surplus, notwithstanding the fact that the taxpayer had increased his war capacity by postwar expenditures. Postwar expenditures to increase capacity held to be a useless surplus have in all cases been ignored.

While the purpose of the amortization provision was to encourage the acquisition of facilities for the production of war necessities, a large part of the allowances are upon facilities acquired by contract entered into before April 6, 1917.

Amortization has also been allowed on pre-war facilities in full operation on April 6, 1917, because they were transferred from a corporation to its subsidiary or by a group of corporations to a consolidation without any real change of ownership or increase of capacity for war production.

There has been gross discrimination in arbitrarily allowing amortization for reduced postwar cost of replacement in some cases and in denying it in others similarly situated, in allowing amortization to some transportation companies, while it is generally denied others, and in allowing amortization on land.

The committee was furnished a list of all amortization allowances passed by the amortization engineers of the income tax unit to and including April 30, 1925. The engineers' reports on all cases in which the total allowance exceeded $500,000 have been examined by the committee's staff. A statement of the amounts involved in each of these cases is appended at the end of this section of their report.

The following is a summary of the results obtained from a survey of all amortization allowances in excess of $500,000 each made by the amortization section (appraisal section) of the income tax unit from the time the amortization provision of the revenue act became effective to April 30, 1925.

SUMMARY OF SURVEY OF ALL AMORTIZATION ALLOWANCES IN GROUP 1

Group 1 includes all amortization allowances in excess of $500,000 each up to and including April, 1925.

TOTALS, GROUP 1

1. Total amount originally claimed	$459,844,015.14
2. Total amount finally claimed	635,934,923.16
3. Total amount finally allowed	425,921,945.92

BASIS ON WHICH AMORTIZATION IS ALLOWED—GROUP 1

4. Amortization allowed on property discarded or sold	172,625,445.74
5. Amortization allowed on reduced replacement cost	65,712,505.79
6. Amortization allowed on reduced value in use	187,583,994.39
Total	425,921,945.92

ANALYSIS OF AMOUNT PROPERLY OR IMPROPERLY ALLOWED—GROUP 1

7. Amortization based on solicitor's ruling[1] and on sound engineering principles	215,256,585.52
8. Amortization not based on solicitor's ruling[1]	136,116,453.66
9. Amortization not based on sound engineering princples	74,548,906.74
Total	425,921,945.92

STATUS OF CASES IN BUREAU AS OF APRIL 30, 1925—GROUP 1

10. Closed under 1312 or 1006 agreement	22,597,789.94
11. Outlawed cases	117,778,885.43
12. Inactive cases	32,424,553.40
13. Open cases	253,120,717.15
Total	425,921,945.92

Total number of cases covering above total=168.

[1] Ruling of Solicitor Hartson in J. I. Case Threshing Machine Co. August, 1923, I. T. 2101; C. B. III-2, 141.

Analysis of allowances properly and improperly allowed in open or closed cases—Group 1

Cases	Allowance based on solicitor's ruling or sound principles	Allowance not based on solicitor's ruling nor sound principles	Total
(a) Legally open	$146,007,579.24	$139,537,691.31	$285,545,270.55
(b) Legally closed	69,249,006.28	71,127,669.09	140,376,675.37
Total	215,256,585.52	210,665,360.40	425,921,945.92

Allowances on discarded or sold property have not been questioned, except in two cases as follows:

1. Where the allowance is made on a discarded value based on the proposition that while the facility is in use, its value in use is less than the discarded value.
2. Where the discarded value has been practically guessed at by applying one estimated percentage to the cost of a whole group of items of a different character and an obviously different ratio of salvage value to cost.

Allowances based on reduced postwar replacement cost have not been questioned except in a few cases where the department's own rules for applying ratios were broken without an adequate substitute being set up.

Except as above noted the allowances to which exceptions have been taken are based on reduced value in use of facilities retained in use. The greater part of these exceptions are based on the ruling of the Solicitor of Internal Revenue, which has not been followed, and the remainder on considerations which would seem obvious to any engineer.

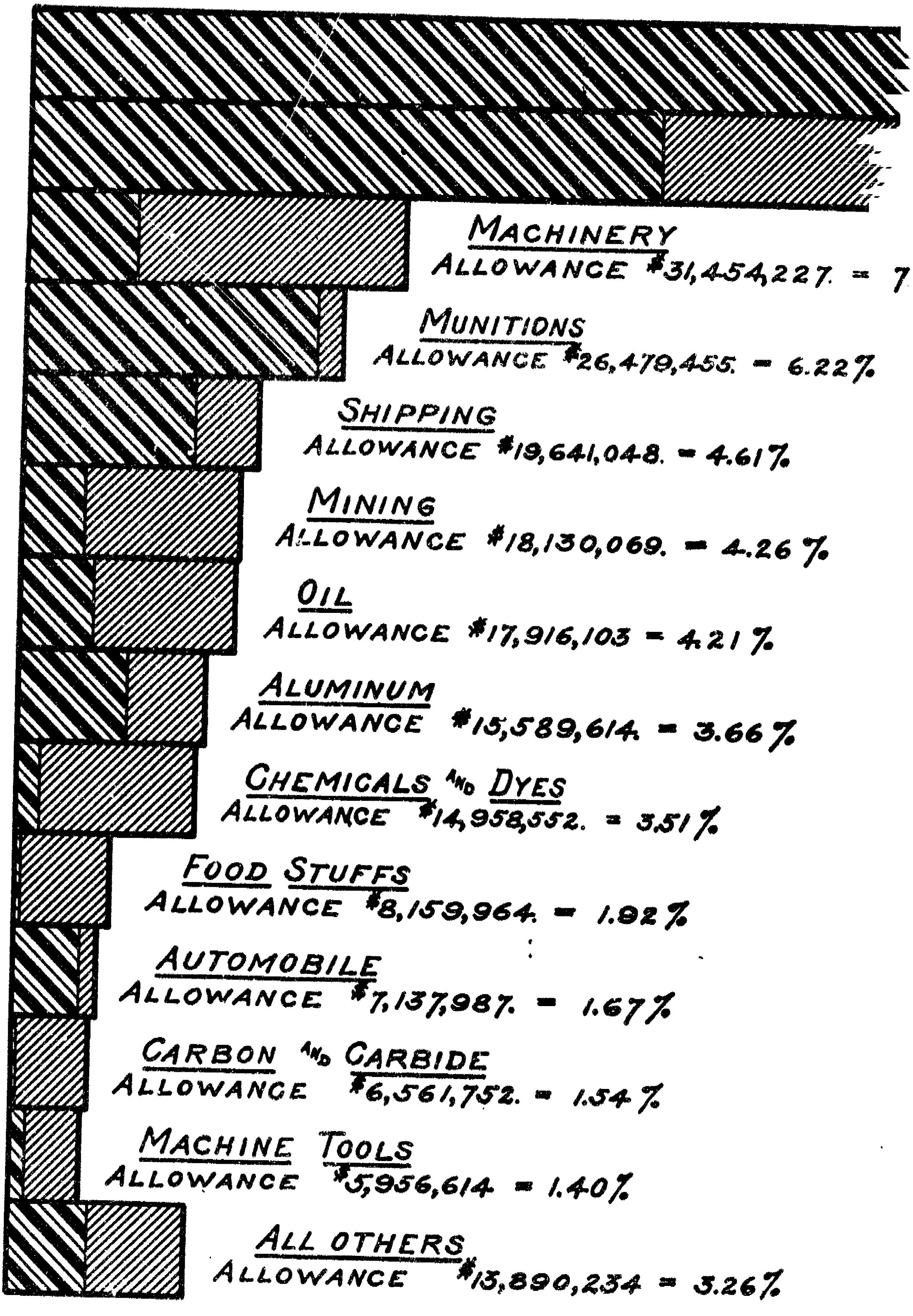
There follows some estimates and conclusions drawn from the figures above stated.

The following estimates are based on percentages derived from the actual examination of 168 amortization cases involving allowances of $425,921,945.92 or 71 per cent of the total allowances made up to April 30, 1925:

Amortization as administered by the bureau

1. The total amount of amortization, which has been, and probably will be allowed, will closely approximate the amount of	$647,276,945.72
2. The portion of this total allowance, which occurs in open cases, or cases which can be legally opened, will closely approximate the amount of	450,527,231.27
3. The portion of this total allowance, which occurs in cases closed by agreement or outlawed, will closely approximate the amount of	196,749,714.45
4. The amount of improper allowances, which have been, or will be allowed, if the past methods are employed in open cases, or cases which can be opened, will closely approximate the amount of	220,172,657.92

SPECIAL NOTE.—The above improper or questionable allowances may be stopped by prompt action as they exist in cases which are either open or which can be legally opened.


MACHINERY
ALLOWANCE $31,454,227. = 7
MUNITIONS
ALLOWANCE $26,479,455. = 6.22%
SHIPPING
ALLOWANCE $19,641,048. = 4.61%
MINING
ALLOWANCE $18,130,069. = 4.26%
OIL
ALLOWANCE $17,916,103 = 4.21%
ALUMINUM
ALLOWANCE $15,589,614. = 3.66%
CHEMICALS AND DYES
ALLOWANCE $14,958,552. = 3.51%
FOOD STUFFS
ALLOWANCE $8,159,964. = 1.92%
AUTOMOBILE
ALLOWANCE $7,137,987. = 1.67%
CARBON AND CARBIDE
ALLOWANCE $6,561,752. = 1.54%
MACHINE TOOLS
ALLOWANCE $5,956,614 = 1.40%
ALL OTHERS
ALLOWANCE $13,890,234 = 3.26%

SHIPBUILDING
ALLOWANCE $75,698,144. = 17.77 %

38 %

LEGEND:

ESTIMATED PROPER ALLOWANCE

ESTIMATED IMPROPER ALLOWANCE

ALL PERCENTAGES SHOWN
ARE RATIOS TO GRAND TOTAL
$425,921,945.

THE ALLOWANCES ARE TOTALS OF THOSE OVER $500,000. EACH, IN THE INDICATED INDUSTRIES. THE GRAND TOTAL IS 71% OF ALL AMORTIZATION ALLOWANCES BY THE UNIT UP TO APRIL 30, 1925.

PRINCIPAL INDUSTRIES BENEFITING BY THE AMORTIZATION CLAUSE

5. The amount of improper allowances, which have been allowed in cases closed by agreement, or outlawed will closely approximate the amount of $99,693,080.31

SPECIAL NOTE.—The above improper allowances occurring in legally closed cases would appear to be "water over the dam."

The following table shows the distribution of amortization allowances among industries and the amount allowed each industry which is questioned. These figures are depicted graphically by the chart on the opposite page.

Amortization allowances—Group I

SUMMARY, BY INDUSTRIES

Name of industry	Number of cases	Total allowance (A)	Amount questioned open (B)	Amount questioned closed (C)
Abrasives	1	$1,002,977.30	$777,204.14	
Aluminum	1	15,589,614.39	6,438,538.16	
Automobile	2	7,137,987.80		$1,649,436.52
Carbon and carbide	1	6,561,752.09		6,316,956.01
Chemicals and dyes	4	14,958,552.52	13,025,981.46	
Foodstuffs	7	8,159,064.00	4,671,221.26	2,969,706.84
Iron and steel	37	164,348,177.57	65,137,809.81	20,320,535.19
Machinery	20	31,454,227.32	11,141,490.79	11,301,358.56
Machine tools	8	5,956,614.15	1,443,077.53	3,283,484.52
Mining	10	18,130,069.09	10,518,889.29	2,288,593.77
Miscellaneous	6	4,495,424.97		1,628,347.11
Munitions	10	26,479,455.62	1,998,530.56	207,098.18
Oil	8	17,916,103.89	10,349,234.16	1,348,914.35
Scientific industries	1	2,377,789.21	954,000.13	
Shipbuilding	36	75,698,144.55	6,575,468.21	16,247,393.02
Shipping	14	19,641,048.48	3,175,309.14	2,100,861.29
Soap	1	3,997,848.67	3,330,936.67	
Tires and rubber	1	2,016,194.30		1,464,983.73
Grand total	168	425,921,945.92	139,537,691.31	71,127,669.09

Name of industry	Number of cases	Total amount questioned (D)	Percentage allowed to grand total allowed, A+425,921,945.92	Percentage allowed questioned to total allowed in industry D+A	Percentage allowed questioned in open cases to total allowed in industry, B+A
Abrasives	1	$777,204.14	0.24	77.49	77.49
Aluminum	1	6,438,538.16	3.66	41.30	41.30
Automobile	2	1,649,436.52	1.67	23.11	
Carbon and carbide	1	6,316,956.01	1.54	96.27	
Chemicals and dyes	4	13,025,981.46	3.51	87.08	87.08
Foodstuffs	7	7,640,928.10	1.92	93.64	57.25
Iron and steel	37	85,458,345.00	38.59	52.00	39.63
Machinery	20	22,442,849.35	7.38	71.35	35.42
Machine tools	8	4,726,562.05	1.40	79.35	24.23
Mining	10	12,807,483.06	4.26	70.64	58.02
Miscellaneous	6	1,628,347.11	1.05	36.22	
Munitions	10	2,205,328.74	6.22	8.33	7.55
Oil	8	11,698,148.51	4.21	65.29	57.76
Scientific industries	1	954,000.13	.56	40.12	40.12
Shipbuilding	36	22,822,861.23	17.77	30.15	8.69
Shipping	14	5,276,170.43	4.61	26.86	16.17
Soap	1	3,330,936.67	.94	83.32	83.32
Tires and rubber	1	1,464,983.73	.47	72.66	
Grand total	168	210,665,360.40	100.00	49.46	32.78

STATUTORY PROVISION

Practically all amortization allowances have been made since the enactment of the Revenue Act of 1921, under subdivision 8 of section 234 of that act, which provides as follows:

> In the case of buildings, machinery, equipment, or other facilities, constructed, erected, installed, or acquired on or after April 6, 1917, for the production of articles contributing to the prosecution of the war against the German Government, and in the case of vessels constructed or acquired on or after such date for the transportation of articles or men contributing to the prosecution of such war, there shall be allowed, for any taxable year ending before March 3, 1924 (if claim therefor was made at the time of filing return for the taxable year 1918, 1919, 1920, or 1921), a reasonable deduction for the amortization of such part of the cost of such facilities or vessels as has been borne by the taxpayer, but not again including any amount otherwise allowed under this title or previous acts of Congress as a deduction in computing net income. At any time before March 3, 1924, the commissioner may, and at the request of the taxpayer, shall, reexamine the return, and if he then finds as a result of an appraisal or from other evidence that the deduction originally allowed was incorrect, the income, war-profits, and excess-profits taxes for the year or years affected shall be redetermined and the amount of tax due upon such redetermination, if any, shall be paid upon notice and demand by the collector, or the amount of tax overpaid, if any, shall be credited or refunded to the taxpayer in accordance with the provision of section 252.

PURPOSE OF AMORTIZATION

The provision for amortization was first included in the revenue act of 1918. We were then at war. The maximum production of war necessities was required. The maximum increase in the facilities for such production was essential. Capital invested in such facilities represented proper capital charges so long as war conditions continued, but the fact was recognized that some of the capital values of war investments in manufacturing facilities would disappear with the restoration of normal postwar conditions. Such loss of capital value is actually an expense or cost incurred in producing the income of the war period.

In the absence of this provision the capital invested in war facilities would be recoverable, tax-free, only through the allowance for depreciation, which is spread over the life of the property, or as an allowance for the loss of useful value, which may be taken when the facility is discarded. It was recognized by Congress that depreciation spread over the life of facilities acquired at war costs for war production would not permit a sufficient deduction from the gross income of war years, so that such income would reflect the true net income of those years, and that without the relief afforded by the amortization deduction taxpayers would be taxed at the high war rates upon apparent but not actual profits.

The purpose of this provision was not to permit deduction of capital invested in facilities in addition to depreciation, but was to permit such a spread of depreciation as would reflect in the capital account the actual postwar capital value of facilities acquired during the war. This purpose is accomplished by permitting the deduction from the income of the war years as an expense of those years amounts which had been charged to capital, but which represents values, which were lost by the termination of the war conditions. Properly construed, this provision permits the recomputation of war income by spreading over the war period the capital losses which occurred at the close of the war as incident to the operations of war years instead of leaving such losses in the capital accounts of the taxpayer to be spread over the life of the property as depreciation.

Purpose of Statute to Stimulate Production Ignored

The statute expressly limits the right to amortize war capital losses to those sustained upon facilities "constructed, erected, installed, or acquired after April 6, 1917, for the production of articles contributing to the prosecution of the war." From this limitation it is obvious that the purpose of this provision was to stimulate the production of articles contributing to the prosecution of the war by encouraging the construction, erection, installation, and acquisition of the facilities required for that purpose. It is also obvious that the purpose of this limitation was to bar the application of the amortization deduction to facilities which were not acquired after we entered the war and to facilities not constructed, erected, installed, or acquired for the purpose stated. It was manifestly the purpose of Congress to deny this privilege with respect to facilities which had been acquired prior to our entrance into the war for the purpose of participating in the huge profits being realized from the manufacture and sale of articles to the Allies.

PRE-WAR COMMITMENTS IGNORED

A very substantial portion of the amortization allowances have been upon facilities contracted for in 1916 but not completed and paid for until after April 6, 1917. Such facilities, having been contracted for prior to April 6, 1917, were acquired for the purpose of participating in the profits incident to the sale of materials to the Allies, and were not acquired for the purposes contemplated by this act.

Regulations 62, article 183, provides—

In the case of facilities the construction, erection, installation or acquisition of which was commenced before April 6, 1917, and completed subsequent to that date, amortization will be allowed with respect only to that part of the cost incurred on or after April 6, 1917, and which was (or should have been) properly entered on the books of the taxpayer on or after that date.

It required a considerable period of time after contracting for a large building or large units of equipment for the construction and installation of such facilities. Such facilities were seldom, if ever, paid for in advance. Such contracts usually call for payment upon completion, or for progress payments during the progress of the work. Thus practically every large claim for amortization includes allowances upon facilities for the construction or acquisition of which the taxpayer was bound by contract prior to April 6, 1917, but which were not fully paid for on that date. In such cases it has been the uniform practice of the income tax unit to allow amortization upon the payments coming due subsequent to April 6, 1917. The committee's staff has made no attempt to segregate the costs amortized on facilities contracted for prior to April 6, 1917. A very large percentage of the cost amortized in the United States

Steel Corporation case falls in this class, and special attention is called to the following cases of amortization allowed on ships:

Atlantic Coast Co.—Three schooners contracted for before April 6, 1917.

Atlantic & Pacific Steamship Co.—Amortization of $1,029,223 allowed on a steel vessel contracted for February 17, 1917.

Atlantic Refining Co.—Amortization of $2,365,958 allowed on four steel transfers all contracted for in 1916.

Luckenback Steamship Co.—Amortization has been allowed on four vessels contracted for in 1915 and 1916. Amortization amounting to $449,000 has been allowed on original contract price. Costs on account of changes and extras during the war period are not questioned.

While contractual commitments prior to April 6, 1917, have not been considered by the Income Tax Unit in determining whether a capital expenditure was amortizable, such commitments have been considered in spreading the amortization allowance as a deduction.

Regulations 62, article 185, provides:

The amortization allowance shall be apportioned (*a*) in cases where the property was employed in the production of articles contributing to the prosecution of the war, over the respective accounting periods of the taxpayer, having reasonable regard to his gross and net income, and where separately ascertainable the income from the facilities upon which amortization is claimed, between January 1, 1918 (or if the property was acquired subsequent to that date, January 1 of the year in which acquired), and the actual or estimated date of cessation of operations as a war facility, and (*b*) in cases where the property was not completed in time for use in the production of articles contributing to the prosecution of the war, on the basis of the expenditures made on account of which amortization is allowed

BERWIND-WHITE COAL MINING CO.

In the Berwind-White Coal Mining Co. case (761), the plant was not completed until after the close of the war, and under the above-quoted regulation the amortization should have been spread over the war years in proportion to the expenditures upon the plant amortized.

This plant was amortized on the basis of 47.4 per cent value in use. The 1919 expenditures upon the plant were $218,653.27, and 47.4 per cent of this amount is $103,641.65. Thus, if amortization had been spread upon either actual cash expenditures or payments which became due, which is the basis used in determining the allowance of amortization upon items contracted for prior to April 6, 1917, the amount deductible from 1919 income would have been $103,641.65. The amount which this taxpayer was permitted to deduct from 1919 income was $333,299.95, which decreased the tax about $180,000 more than the decrease would have been had amortization been spread on the basis of actual payments or the maturity of obligations.

The representatives of the bureau maintained that the distribution made in the Berwind-White case was proper, and in accordance with the regulations. They contended that a "commitment" was tantamount to an expenditure, and that this taxpayer had made commitments in 1919 which were used as the basis of spreading the amortization allowance.

In addition to the Berwind-White case, amortization was spread on the basis of commitments in the following cases:

Name of taxpayer	Date of report	Amount of costs involved
Jones & Laughlin Steel Co	Oct. 24, 1923	$28,193,771.08
Midvale Steel & Ordnance Co	Feb. 18, 1924	24,928,520.34
E. I. du Pont de Nemours Co	May 24, 1923	25,601,464.69
American Steel & Wire Co		16,916,995.98

This statute makes no mention of either "expenditures" or "commitments." The statute provides for the amortization of "costs." It is obvious that the word "cost" should not mean one thing when the right to amortize is involved and something else when the spread of amortization is involved. If taxpayers are to be allowed to deduct amortization from the income of war years, on costs paid or obligations matured since the close of the war, because they became bound by commitments during the war, the same rule should be applied to commitments entered into before the war, and amortization should be denied on facilities contracted for before April 6, 1917.

What has been said is not to be understood as implying that it has been the consistent policy of the Income Tax Unit to spread amortization allowances on commitments, instead of upon payments or matured obligations. There has been no definite policy with respect to any phase of the subject of amortization. The method of spreading amortization in the case of the amortization allowance to the McKeesport Tin Plate Co. proves that there has been gross discrimination in spreading, as well as in allowing, amortization.

The McKeesport Tin Plate Co. built a new power plant and scrapped an old one, as did the Berwind-White Co. The McKeesport Co. claimed the right granted the Berwind-White Co. to spread its allowance on the basis of commitments, but this right was denied the McKeesport Co. and it was required to spread amortization on payments.

AMORTIZATION ON PREWAR FACILITIES

This statute has been construed by Income Tax Unit to allow amortization upon the mere legal fiction of acquisition, where there was no increase in productive capacity for war purposes, and where the acquisition and subsequent discarding of plants was for the sole purpose of consolidating an industry and killing competition.

NATIONAL ANILINE & CHEMICAL CO.

The amortization allowance of $9,912,740.08 to the National Aniline & Chemical Co. is a case in point.

This company was organized in May, 1917, for the purpose of consolidating the property of seven going chemical companies, located in seven different eastern cities. The property of each company was appraised for the purpose of consolidation by a committee of engineers employed by the group. Each property was taken into the consolidation at its appraisal value, and the stockholders of the old companies exchanged their stock for the stock of the new company.

The appraised value of the old plants was $18,669,800. There appears to have been war expenditures of $1,451,873.57, which may be properly amortizable, but the balance of the costs amortized was the appraised value of going plants, whose capacity for the production of war articles was in no way affected by the consolidation.

During the war period these plants were continued in operation. After the close of the war, the consolidated company concluded to abandon all of their plants, except one located at Buffalo. The allowance of $8,258,989.43 was based upon the difference between the going concern value, at which these discarded plants were taken into the consolidation, and their dismantled scrap value. To have offered the surplus plants for sale, as going concerns, would have preserved competition, and would have defeated the purpose of the consolidation.

Thus this taxpayer was enabled to get rid of competition and dispose of a pre-war surplus capacity and was permitted to deduct the loss it voluntarily assumed to accomplish these purposes from its income, as the amortization of war facilities, although the amortization allowed upon these plants did not involve one cent expended to create a capacity for the production of articles contributing to the prosecution of the war.

As has been said, there was a war expenditure of $1,451,873.57 for new facilities, but there is nothing to show that these facilities are not in full use in the enlarged Buffalo plant.

Assume that A is the owner of an old shop equipped with obsolete machinery. Before the war this shop was practically valueless because it was too inefficient for economical operation. During the war high prices permitted the profitable use of this obsolete plant. At the close of the war the plant can be no longer operated. A dismantles the plant, and having made no war expenditures has nothing upon which to base a claim for amortization.

If, however, A organized a corporation and turned this plant over to the corporation in exchange for its capital stock, under the principle applied in the National Aniline & Chemical Co. case, he can amortize the difference between the value at which this plant was exchanged for stock and the scrap value of the dismantled plant. Furthermore, under the principle applied in that case, he can amortize down to scrap value, even though he could realize more than scrap value by selling the plant as a going concern.

SOLICITOR'S RULING

The allowance of amortization in the National Aniline & Chemical Co. case is approved in principle by a ruling of the solicitor in another case (S. R. 2195). (Cumulative Bulletin III-2, 143.)

Prior to April 6, 1917, the O company contracted with a shipbuilder for the construction of a steamship, which was delivered to the O company on April 17, 1917. Seventy-four per cent of the cost of this vessel had been paid prior to April 6, 1917, and the balance was paid subsequent to that date.

Under the regulations to which attention has been called the O company could claim amortization on the 26 per cent of the cost paid subsequent to April 6, 1917. In August, 1917, the O company organized the M company, to which it transferred title to this steamship in exchange for the entire capital stock of the M company and a note of the M company for more than the O company paid for the ship. This note was subsequently paid. The ship was sold by the O company to its subsidiary, the M company, for nearly 50 per cent more than the O company paid for it.

Amortization was claimed to the M company, based upon the difference between the cost of this ship to the O company and its postwar replacement value. The amortization section threatened to disallow this claim on the ground that the sale was not bona fide and that the O company would only be entitled to amortization based upon the 26 per cent of the cost paid after April 6, 1917.

The solicitor held that notwithstanding the facts that the ship was contracted for by the O company prior to April 6, 1917, and 74 per cent of the cost paid before that date, and that the O company owned all of the stock of the M company, the M company was entitled to amortization based upon the full cost of the ship.

The surprising thing about this case is that the M company did not claim amortization based upon what it paid the O company for the ship, as under the principles applied by the solicitor this cost would be amortizable.

In this case no new facility came into existence. The tonnage of available shipping was not increased by one ounce. This ship was acquired and 74 per cent of its cost paid by the O company prior to April 6, 1917. Under these conditions the O company was entitled to no amortization under the provisions of the act, although under the regulations the O company could claim amortization on the 26 per cent of the costs paid subsequent to April 6, 1917. Now, by merely organizing a subsidiary, the M company, and by transferring the title to this ship to it, the O company, through this subsidiary, is allowed amortization based upon the entire cost of a ship acquired before April 6, 1917, and 74 per cent of the cost of which was paid prior to that date.

AMORTIZATION BASED ON OWNERSHIP OF CORPORATE STOCK

In many cases amortization has been allowed on the property of corporations which produced no articles which contributed to the prosecution of the war. In such cases the allowance has been based upon the fact that the corporate stock of the taxpayer was owned by a corporation which either produced articles contributing to the prosecution of the war or owned the stock of a third corporation which produced such articles. It is very clear that the law makes the right to amortize war losses dependent upon the use for which the taxpayer acquired the facility, and not upon the ownership of the taxpayer's corporate stock.

AMORTIZATION OF RAILROAD, PIPE LINE, AND HOUSING FACILITIES

Railroads generally have been denied amortization. While barred by the law, as construed by the regulations, the solicitor, and the courts, amortization has been allowed upon railroads, pipe lines, housing, and other facilities, the use of which merely contributed to production, but which did not actually produce articles contributing to the prosecution of the war, when such facilities were owned by corporations whose stock was held by another corporation which did produce such articles, or owned the stock of a third corporation which produced such articles.

The provision limiting amortization to facilities "for the production of articles contributing to the prosecution of the war," has been uniformly held by the solicitor and the Federal courts, to bar railroads from the privilege of amortizing their capital war charges

Regulations 62, article 183, provides:

The allowance may be deducted only by taxpayers who after April 6, 1917, have constructed or otherwise acquired plant or other facilities for the actual production of articles contributing to the prosecution of the war. It is not sufficient to entitle the taxpayer to the allowance, that the nature of his business is such as to contribute to the production of articles. For example, a taxpayer, such as a railroad, whose business activities are confined to transportation (other than water transportation) is not entitled to the allowance. A taxpayer, the nature of whose business is the actual production of articles, however, may claim the allowance with respect to the cost of all buildings, machinery, equipment or other facilities which were constructed for use or which were used in connection with the production of such articles, both in the acquisition and transportation of raw material, the actual process of manufacture or other conversion, and the transportation and marketing of the finished product.

In 1921, the Solicitor of Internal Revenue held that a railroad corporation is not entitled to amortization. This opinion is L. O. 1074 published in Cumulative Bulletin, December, 1921, page 159. In this opinion the solicitor says:

It is recognized by Congress that the phraseology used in the statute in regard to the amortization allowance on buildings, machinery, equipment, and war facilities is not sufficiently broad to admit of an allowance of facilities used for transportation. The act as originally passed by the House (H. R. 12863), in respect to amortization (secs. 214 (a) 9, 234 (a) 8), did not contain the language in respect to ships now found in the statute but provides for the allowance in the following language:

"In the case of buildings, machinery, equipment, or other facilities constructed, erected, installed, or acquired on or after April 6, 1917, for the production of articles contributing to the prosecution of the war there may be allowed a reasonable deduction for the amortization or such part of the cost of such facilities as has been borne by the taxpayer * * *"

In the report of the Senate Committee on Finance dated December 6, 1918, the following remarks are made in respect to amortization:

"In the paragraph relating to amortization allowance (secs. 214 (a). 234 (a)8), was feared that the language was not broad enough to include vessels devoted to war purposes, and provision has therefore been made for amortization allowance in the case of vessels constructed or acquired on or after April 6, 1917, for the transportation of articles or men contributing to the prosecution of the present war."

The amendment referred to in the Senate committee report resulted in the existing provisions of the statute.

Therefore Congress recognized that the language used in the first part of the section was not sufficient to embrace transportation facilities and advisedly broadened the section only in so far as to include ships.

While the additional facilities purchased by the M railroad company enabled it to meet the extraordinary demands occasioned by the war, they are not such facilities as may be said to have been used for the production of munitions manufactured by the companies whose plants were built in the vicinity of its right of way. Transportation can not be regarded as a part of production and this is evidently the construction which Congress intended should be put upon the statute.

It is held that where railroads constructed additional track lines, sidings, stations, roundhouses, and repair shops, and purchased additional locomotives and cars in order to meet the demands on such roads occasioned by the war, no allowance may be made for amortization, as those facilities do not fall within the classes enumerated in section 234 (a) 8 of the revenue act of 1918. The entire allowance for amortization claimed by the M railroad company should therefore be denied.

In the case of the Hampton & Langley Field Railway Co. *v.* Noel, collector (300 Fed. 438), decided June 13, 1924, the United States District Court for the Eastern District of Virginia, decided that a railroad company was not entitled to amortization. The reasoning of the court follows the reasoning of the solicitor in the opinion that I have just read.

The facts in the case before the court were as follows:

The facts show that the plaintiff, hereinafter spoken of as the railway, is a public service corporation, organized under the laws of Virginia in February, 1917. Between the middle and the latter part of 1917 it built approximately 3¼ miles of standard-guage railroad, starting at Hampton, Va., intersecting the Chesapeake & Ohio Railway at the edge of the town, and running to the outer boundaries of Langley Field aviation station, belonging to the United States. At this terminus there was a physical connection with the Government tracks running into the aviation field. At its inception the railway used rolling stock leased from the Newport News & Hampton Railway Gas & Electric Co., but at the peak of war activities the latter company, finding itself in need of all its equipment, withdrew its rolling stock, necessitating the purchase by the railway for its own account of such equipment as its business demanded. Accordingly it purchased, after April 8, 1917, two electric passenger cars and one electric locomotive, paying in the aggregate therefor the sum of $34,400. The passenger cars were used in hauling passengers from Hampton to Langley Field, and the locomotive in drawing freight cars received from the Chesapeake & Ohio Railway from the point of physical connection with that company's line to the outskirts of the aviation field, where the cars were delivered to the Government authorities and drawn by means of a steam locomotive, operated by the United States Army, to the desired points in the aviation field.

Notwithstanding this ruling and decision by the Federal Court, amortization amounting to $2,789,185.49 was allowed to common carrier railroad corporations whose stock is owned by the United States Steel Corporation and its subsidiaries.

There was an attempt to justify this allowance upon the ground that these companies were owned by the United States Steel Corporation.

There is nothing in the law which bases the right of a taxpayer to amortization upon the ownership of its capital stock.

Under the act, the right to amortize property depends upon the date of its acquisition and the use for which it was acquired. The solicitor and the court had held that the transportation of articles is not the production of articles. The regulations, however, permit amortization upon transportation facilities, provided the taxpayer was engaged in the business of producing articles contributing to the prosecution of the war. It is unnecessary to consider the soundness of this regulation, which would allow amortization upon railroad facilities, provided they were owned by a producer of articles, while it denied amortization upon the same kind of facilities, used for the same purpose, if owned by a railroad company. In the United States Steel case the corporate taxpayers were not producers of articles. In each instance they were railroad companies having no different status than any other railroad corporatioan, except that their stock was owned by the United States Steel Corporation.

The United States Steel Co. produced nothing, but it is the owner of the stock of other corporations, which did produce articles contributing to the prosecution of the war. Thus, we have railroad companies allowed amortization, because their stock was owned by a corporation, which owns the stock of another corporation, which comes within the class entitled to amortization.

In his recent ruling in the United States Steel case, Solicitor Gregg has ruled that the railroads owned by the United States Steel Co. are not entitled to amortization, but his ruling does not effect the allowance of amortization to other railroad companies similarly situated.

The following tabulation shows allowances to railroad corporations, which were made upon the ground that their stock was owned by corporations which were eligible to take amortization.

Railroad company	Owner of railroad company stock	Amount allowed
Colorado & Wyoming R. R. Co.	Colorado Fuel & Iron Co.	$131,565.98
Chapana R. R. Co.	Cuban-American Sugar Co.	579,572.70
Aliquippa & Southern R. R. Co.	Jones & Laughlin	156,241.38
Monongahela Connecting R. R. Co.	do	126,710.50
Bingham & Garfield R. R. Co.	Utah Copper Co.	310,188.77
Arizona Extension R. R. Co.	United Verde Extension Mining Co.	252,756.97
Total		1,557,036.30

The above allowances were found in cases involving total allowances of $500,000 and over. Many similar allowances can doubtless be found in cases involving less than $500,000, as it was the policy of the engineering division to make such allowances notwithstanding the rulings of the solicitor and the decisions of the courts until this question was brought to the attention of this committee.

PIPE LINES

There can be no sound distinction between railroads and pipe lines owned by pipe-line companies. Both are common carriers, furnishing transportation, and a pipe-line company is no more a producer of an article contributing to the prosecution of the war than is a railroad. In the following cases, involving over $500,000, amortization has been allowed to pipe-line companies on the ground that their stock was owned by oil-producing companies.

Pipe line company	Owner of pipe line company	Amount allowed
Texas Pipe Line Co.	Texas Co.	$2,044,142.65
Texas Pipe Line Co. of Oklahoma	do	110,847.66
Sun Pipe Line Co.	Sun Oil Co.	4,296.96
Sinclair Cudahy Pipe Line Co.	Sinclair Oil & Refining Co.	259,468.72
Total		2,418,755.99

HOUSING

A corporation which erected houses during the war is clearly not entitled to amortization, and no amortization has been allowed upon housing, unless the stock of the housing corporation was owned by a corporation, which is eligible to take amortization.

In his recent ruling in the United States Steel case, Solicitor Gregg has condemned such allowances for housing to subsidiaries of the United States Steel Co. Such allowances were made in the following cases involving over $500,000.

Housing company	Parent company	Amount claimed	Amount allowed
Watson Hill Development Co., Quincy, Mass.	Bethlehem Steel Corporation	$245,624.87	$245,624.87
Steelton Plant, Bethlehem Steel Co., Steelton, Pa.	do	11,823.21	7,674.72
Tennessee Land Co., Tennessee	United States Steel Corporation.	1,021,957.89	341,095.59
Chickasaw Land Co., Chickasaw, Ala	do	3,111,646.70	2,671,477.28
Gary Land Co., Gary, Ind	do	33,790.84	33,790.84
The Clyde Co., Clyde City, Calif	Pacific Coast Shipbuilding Co.	946,145.55	735,008.12
Westinghouse Air Brake House Building Corporation, Pa.	Westinghouse Air Brake Co	317,349.77	165,846.68
Buckeye Land Co. (various locations) [1]	Youngstown Sheet & Tube Co.	261,199.05	226,303.57
Total		5,949,537.88	4,426,821.67

[1] The engineer's report is rather ambiguous on this item. The taxpayer owned the Buckeye Land Co., which was the holding company for certain housing facilities, but it is not clear whether the facilities upon which amortization was allowed were erected or constructed by this holding company or the parent company.

TANK AND REFRIGERATOR CARS

There is no legitimate foundation for the provision of the regulation, quoted above, basing the right to amortization upon the business of the taxpayer, instead of upon the use for which the facility was acquired. The law provides that the allowance shall be upon facilities "acquired for the production of articles contributing to the prosecution of the war."

The courts have held, and the solicitor has ruled, that transportation facilities of railroads are not amortizable. Regardless of the soundness of this ruling it is clear that if the transporting of articles in cars owned by a railroad is not such a part of production as to make the cost of such cars amortizable, the fact that the same cars are owned by the producer of the article does not alter the character of transportation as an element of production. If transportation is an element of production, within the meaning of this law, all railroads are entitled to amortization. If transportation is not an element of production for amortization purposes, transportation facilities, regardless of who owns them, are not amortizable.

While amortization has been denied railroads, except when their stock is owned by a corporation which produced articles contributing to the prosecution of the war, and while even these allowances are condemned by the solicitor, amortization has been allowed upon tank, refrigerator, and other railroad cars, in cases involving allowances exceeding $500,000, as follows:

Taxpayer	Facilities	Allowed
La Belle Iron Works	Gondola, tank and hopper cars	$72,000.98
Republic Iron & Steel Co	Coal cars	159,127.[illegible]4
Proctor & Gamble	Tank cars	1,634,020.13
Sun Co	do	103,734.00
Sinclair Oil Co	do	320,793.96
Pure Oil Co	do	788,659.59
Cincinnati Abbatoir Co	Refrigerator cars	52,736.32
Indian Refining Co	Tank cars	399,121.28
Midland Refining Co	do	256,676.16
Pierce Oil Co	do	437,820.65
Jones & Laughlin Steel Co	Hopper cars and bodies	55,777.83
Do	Gondola cars	60,704.51
Do	Freight cars	404,017.51
Do	Gondola cars	
Do	Coke cars	
Do	Hopper cars	
Do	Car bodies	66,826.94
Total		4,777,917.00

What has been said with reference to railroad cars, owned by a producer, has equal application to pipe lines, owned directly by oil producers. Pipe lines owned directly by the Pierce Oil Co. were the subject of an allowance of $832,568.85 for amortization.

AMORTIZATION ALLOWANCES ON LAND

The allowance of amortization on land was discussed before the committee. When asked if amortization could be applied to land, Mr. Gregg, solicitor for the bureau, answered as follows:

> No, sir; we have ruled specifically that it does not apply to land (p. 3185).

It was also admitted before the committee that amortization on land had been allowed in some few cases among which were: Todd Shipyard Corporation, Trojan Powder Co., J. H. Williams & Co., Guantanamo Sugar Co., South Porto Rico Sugar Co.

In course of our investigation of amortization cases containing allowances of over $500,000 each, the committee's staff has discovered other important instances where amortization has been allowed on land.

These cases are tabulated below, showing the name of taxpayer, cost of land, and amortization claimed and allowed on the land:

Taxpayer and location of land	Cost	Amortization	
		Claimed	Allowed
American Locomotive Works, Chester, Pa	$229,047.32	$54,047.32	$4,047.32
Moore Shipbuilding Co., Oakland, Calif	741,350.74	[1] 148,720.00	135,200.00
Morgan Engineering Co., Alliance, Ohio, plant	50,883.74	15,701.40	14,401.40
Pacific Coast Shipbuilding Co., San Francisco, Calif. (town of Clyde)	100,000.00	85,000.00	80,500.00
National Carbide & Carbon Co., Clarksburg, W. Va., plant [2]	9,808.16	7,804.69	6,837.23
National Carbide & Carbon Co., Fostoria, Ohio, plant [2]	2,690.84	2,023.80	1,732.33
National Carbide & Carbon Co., Scranton, Pa. (Helios works) [2]	5,861.24	4,692.25	4,692.25
Niles Bement & Pond Co., Kearney, N. J	372,771.00	232,421.00	232,421.00
Federal Shipbuilding Co., Kearney, N. J	1,759,687.94	392,331.32	200,847.72
Bausch & Lomb Optical Co., Rochester, N. Y	248,320.51	192,320.51	62,947.04
Skinner & Eddy Corporation, Seattle, Wash	1,840,892.35	[1] 1,450,072.59	1,318,247.81
Great Lakes Engineering Co., Detroit, Mich	719,149.70	[1] 479,708.67	436,099.70
Jones & Laughlin, Pittsburgh, Pa	49,980.00	31,397.44	18,582.56
Worthington Pump & Machine Co., Holyoke, Mass	178,527.86	39,975.00	39,475.00
American Shipbuilding Co., Chicago plant	7,014.84	4,918.84	4,918.84
Allegheny Steel Co., Pittsburgh, Pa	125,000.00	75,000.00	45,000.00
Total	6,669,494.10	3,287,507.27	2,664,007.71

[1] Nothing could be found in the engineer's report to indicate the exact amount claimed. It is assumed that the claim is at least 10 per cent more than the amount allowed, therefore this (10 per cent) has been used.

[2] Includes roadways and fences.

It can be seen from the above figures that even in the cases examined allowances in excess of $2,600,000 have been made. Of this amount the allowance of about $300,000 is in legally open cases and may be corrected. The balance of $2,300,000 is in either outlawed cases or in cases in which the commissioner has signed an agreement with the taxpayer under section 1312 of the act of 1921 or section 1006 of the act of 1924.

Whether land is a proper subject of amortization under this act may be a debatable question, but a proper administration of the act demanded an early ruling on this question and the allowance or disallowance of amortization on land in all cases. The practice of the Income Tax Unit in holding land amortizable in some cases, while holding it not amortizable in others, is the worst kind of discrimination.

Millions of dollars have been lost by farmers who purchased land at inflated war values, but, with the exception of two large sugar companies, no allowances upon farm land have come to the attention of the committee's staff.

Further inequity as between taxpayers is very apparent in this matter, as numerous cases are noted where amortization on land is denied. For instance, in the Lincoln Motor Co. case an allowance was refused on land in face of the usual appraisal evidence of a loss.

Amount Properly Amortizable is Capital Loss

The loss sustained upon facilities installed for war production, but which were sold or discarded because not needed, or not suitable for use in the taxpayer's postwar business, is clearly a capital loss attributable to the war period.

As to facilities installed during the war and retained in postwar use, the question to be determined is what value have these facilities which can be properly carried in the postwar capital account of the taxpayer. The difference between the war cost and the postwar value in the business of the taxpayer is the amount by which the capital account should be credited, and the expenses of war years debited, on account of capital charges, that the capital account may reflect the real postwar value of the facilities acquired during the war period, and that the taxable income of the war years may reflect the real profits of those years. It is this difference between war cost of facilities installed during the war period and the postwar value of such facilities to the taxpayer which is properly allowable as amortization.

Computation of Amortization

Regulations 62, article 184, provides for the computation of amortization allowances, as follows:

> * * * The total amount of the amortization allowance is the difference between the original cost of the property if constructed, erected, installed, or acquired on or after April 6, 1917; or if acquired partly before and partly after April 6, 1917, then that part of the cost incurred on or after April 6, 1917, and properly entered on the books of the taxpayer on or after that date, less any amounts deducted for depreciation, losses, etc., prior to January 1, 1918, and the value of the property on either of the bases indicated below:
>
> (1) In the case of property which has been sold or permanently discarded, or which will be sold or permanently discarded before March 3, 1924, the

value shall be the actual sale price or estimated fair market value as of the date when the property was or will be permanently discarded plus a reasonable allowance for depreciation in case the property is used in the taxpayer's business after the close of the amortization period. Such fair market value shall be established by investigation of engineers of the Bureau of Internal Revenue, if such investigation is deemed advisable.

(2) In the case of property not included in (1) above, the value shall be the estimated value to the taxpayer in terms of its actual use or employment in his going business, such value to be not less than the sale or salvage value of the property, and not greater than the estimated cost of replacement under normal postwar conditions less depreciation and depletion. Upon the basis of the costs prevailing at the latest pre-war date at which a reasonable normal market existed, the commissioner shall in respect of basic material and labor costs determine and publish ratios of estimated postwar costs of replacement, and a taxpayer shall use such ratios in computing a claim for a tentative allowance for amortization. Such tentative allowance may be redetermined on or before March 3, 1924, at the request of the taxpayer or by the commissioner.

Special record of all property falling in (1) above, must be preserved by the taxpayer, and the commissioner must be notified with the next tax return (a) if, after having been in good faith permanently discarded or dismantled, property shall in any case be restored to use because of conditions not foreseen or anticipated at the time it was discarded; or (b) of the selling price, if sold.

BASIS OF ALLOWANCES

The allowances aggregating $425,921,945.92 examined by the committee's staff may be segregated into three classes, determined by the basis on which the allowance was made, as follows:

Allowed on property discarded or sold	$172, 625, 445. 74
Allowed on reduced replacement cost	65, 712, 505. 79
Allowed on reduced value in use	187, 583, 994. 39
Total	425, 921, 945. 92

ALLOWANCES ON PROPERTY DISCARDED OR SOLD

The regulation quoted above is clear as to how the allowances on property discarded or sold are to be determined. The determination of allowances on this basis is simple, as the sale or scrap value of such property is readily determined.

It will be noted that the regulations provide that when property amortized as discarded is subsequently brought back into use or sold the taxpayer shall report the facts in his next tax return.

Both the law and regulations are silent as to whether amortization allowed upon discarded property which is afterwards brought back into use shall be treated as taxable income and, if so, whether it shall be taxed at the rate at which it would have been taxed had it not been amortized or at the rate applicable to the year the property is returned to use. Only one case out of over 200 has come to the attention of the committee or its staff where property amortized as discarded has been reported as returned to use. In this case the amortization allowance was revised. Such revision can not be made where the statute no longer permits it, and the law is silent as to how such income shall be treated.

ALLOWANCES BASED ON REDUCED COST OF REPLACEMENT

It is clear that if facilities acquired during the war can be replaced after the close of the war for less than the war cost a capital loss equal to the difference between the war cost and the postwar cost of replacement has been sustained and that such loss is properly amortizable. No such allowances have been questioned by the committee or its staff, except in a very few cases, for special reasons.

LAXITY OF BUREAU IN REVISING RATIOS FOR DETERMINING POSTWAR REPLACEMENT COSTS

While allowances based on the difference between the war cost of a facility and the normal postwar replacement cost of the same facility are manifestly proper and within the scope of the statute, the method of handling this subject by the bureau shows laxity and inaccuracy.

The bureau's method of computing amortization due to lowered postwar replacement cost may be briefly stated as follows:

First, determine the cost of the facility as of June 30, 1916.

Second, classify this facility under one of the standard 16 classifications, as, for example, "Electrical machinery and equipment."

Third, multiply the cost of the facility as of June 30, 1916, by the ratio of pastwar cost to cost as of June 30, 1916, as shown by the published ratios for that specific classification under which the facility falls. The result will be the normal postwar cost of the facility.

Fourth, subtract the normal postwar cost thus obtained from the actual war cost, and the result will be the amortization allowable due to lowered postwar replacement cost.

The published ratios on which the above method is based were published by the Bureau of Internal Revenue in the spring of 1922, as follows:

All ratios are expressed in percentages based on prices as of June 30, 1916.

	Per cent
(A) Ratios for computing estimated postwar cost of replacement of buildings, vessels, cars, tanks, blast furnaces, open-hearth furnaces, annealing furnaces, electric furnaces, coke ovens, and construction of all kinds:	
1. Lumber—	
(a) Hard	240
(b) Soft	175
2. Structural steel	60
3. Building materials (other than lumber and structural steel)	225
4. Steel (other than structural steel) and steel products	90
5. Building equipment	150
6. Labor (all classes)	160
(B) Ratios for computing estimated postwar costs of replacement of machinery and equipment:	
7. Electrical machinery and equipment	130
8. Engines, turbines, compressors, and similar facilities	175
9. Pumps	135
10. Boilers	160
11. Transmission equipment—	
(a) Shafting, pulley, hangers, etc.	135
(b) Belting	100
12. Machine tools and small tools (machine tools are considered as that class of metal-working machinery which can be used on both cast iron and steel)	130
13. Woodworking machinery	155
14. Textile machinery	155
15. All other machinery (including cranes)—	
(a) Machinery, the cost of which did not exceed 10 cents per pound as of June 30, 1916	120
(b) Machinery, the cost of which did exceed 10 cents per pound as of June 30, 1916	130
16. Office furniture and equipment	125

The above ratios were published over the signature of the Commissioner of Internal Revenue and approved by the Secretary of the Treasury under date of May 19, 1922.

T. D. No. 3333, which contains the ratios quoted above, also includes this statement:

> The purpose of establishing these ratios is to facilitate the preparation and examination of claims and to bring about, to such extent as may be practicable, uniformity as to the basis of claims. The allowances based thereon will be purely tentative and subject to redetermination in accordance with the provisions of the law.

These published ratios were actually prepared late in 1921 and in the early part of 1922. We may assume, therefore, that they are based upon postwar prices as of about January 1, 1922. It will be noted from the above quotation that the ratios were "purely tentative," yet no revised ratios have been prepared or published.

Mr. Gregg, in his ruling on the United States Steel case, published October 26, 1925, states as follows in regard to postwar replacement costs:

> * * * It is the opinion of this office that as a general rule the prices for determining postwar replacement costs should be taken as near to March 3, 1924, as is practicable, having in mind the selection of a time within the period from March 3, 1921, to March 3, 1924, when the prices to be decided upon are not affected by abnormal conditions but are nearest normal.

Mr. Gregg's statement would clearly lead us to the conclusion that the ratios established as of January 1, 1922, could not possibly meet the requirements laid down by him.

Further, the engineering division of the bureau implies that these ratios should be discarded, as is shown by their statement in the ruling above referred to:

> If these ratios are now disregarded, as it appears should be done in the redetermination of amortization claims, * * * etc.

From the above we must conclude that all determinations of normal postwar replacement costs are "purely tentative" and inaccurate, because ratios prepared as of January 1, 1922, cannot possibly consider conditions up to and including March 3, 1924, the close of the amortization period. The allowances on this basis alone exceed $65,000,000.

Further, the bureau shows serious laxity in not revising these ratios, as of March 3, 1924, and publishing same on or about that date. Over one year and nine months has elapsed since a revision of these ratios should have been made, and there is still nothing published on this subject.

In regard to the Bureau's method of computing the loss due to lowered postwar replacement costs, as outlined above, it is the opinion of the Committee's staff, that this is unnecessarily complicated and productive of errors.

The bureau's method requires the computation of the June 30, 1916, replacement costs of all items. It requires the computation of ratios showing the relation of June 30, 1916, cost to normal postwar cost. It requires the classification of all items into 16 groups—all of this to secure the postwar replacement cost.

It is just as easy, in fact easier, to get the normal postwar replacement cost as of March 3, 1924, direct as it is to get the June 30, 1916, replacement cost. This direct method would then give us our answer at once and eliminate all the other work of ratios, classifications, and arithmetical computations.

For present purposes we would recommend that in determining normal post-war replacement costs the ratios be discarded and the replacement costs be computed directly as of March 3, 1924.

Allowances Based on Reduced Value in Use

Approximately half of the enormous sums allowed for amortization are based upon loss of value in use. This class of allowances have been the subject of thorough discussion before the committee, and with the exception of the cases herein mentioned, in which the fact is specifically noted that the allowance was on other grounds, all allowances the propriety of which has been questioned by the committee or its staff have been based upon reduced value in use.

NO REGULATIONS NOR RULINGS AND NO UNIFORM NOR CONSISTENT PRACTICE

Regulations 62, which were in force during the period when practically all amortization allowances were made, furnish no further guide for the determination of amortization upon property which has not been sold or discarded than the statement that "the value shall be the estimated value to the taxpayer in terms of its actual use or employment in his going business," which shall not be less than the salvage value nor greater than the post-war cost of replacement. As to how the value of property "in terms of its actual use or employment" is to be ascertained, the regulations are silent.

While the amortization provision was first inserted in the 1918 act, it was not until August 19, 1923, that the first ruling by anyone in authority interpreting this provision of the regulations was made. This ruling was made by Solicitor Hartson in the J. I. Case Threshing Machine Co. case and condemned the basis upon which every large amortization allowance for reduced value in use had been made. This ruling was not published until November 3, 1924, eight months after the expiration of the period within which redetermination of amortization allowances could be made. Although this ruling was made seven months before the expiration of the period within which redetermination could be made, there was not only no attempt to redetermine allowances made upon the condemned basis, but this ruling has not been followed in a single case, not excepting the case in which it was made. (3147–3152.)

UNITED STATES STEEL CORPORATION

The principle involved in allowances for reduced value in use of facilities retained in use were thoroughly discussed before this committee in connection with the amortization allowances made to the United States Steel Corporation. (1015.) In this case the staff of this committee took exception to $27,926,014.01 of the amount allowed on facilities used in the post-war operations of this taxpayer. This item involved a difference in tax of $21,438,513.69. The total allowance for amortization to this taxpayer was $55,063,312.60. No exception was taken to the allowance of $27,-

136,987.89 allowed upon facilities sold or discarded and to cover the reduced cost of replacement of facilities retained in use. The allowances to which exceptions were taken were based entirely upon the claim of reduced usefulness of facilities actually retained in postwar use after full allowance had been made for the loss upon such facilities due to reduced postwar cost of replacement.

Hearings were had on this claim before the committee at different times from December 15, 1924, to January 7, 1925. The representatives of the bureau conceded that the allowances excepted to were made upon a basis condemned by what was then the only published ruling on this subject. It was claimed, however, that the engineering division intended to submit this case to the solicitor's office on other questions, and this allowance might have been caught and stopped by the solicitor.

The fact is, however, that the principles applied in this case were those generally followed in all large cases and that an agreement had been made by the engineers of the Income Tax Unit with this taxpayer whereby it was agreed that this allowance was a permanently closed matter which would not be reconsidered. Immediately after this case had been fully discussed before this committee the Commissioner of Internal Revenue ordered that it be reconsidered. Preliminary to its reconsideration it was submitted to the Solicitor of Internal Revenue for his ruling on 16 questions involving the fundamental principles involved in every amortization allowance.

Principles Not Published Until October, 1925

The solicitor's ruling in this case, published on October 26, 1925, eight years after the amortization provision was inserted in the law, and a year and eight months after the close of the period within which amortization allowances could be redetermined, constitutes the first official statement of the principles which are to govern the determination of amortization allowances ever promulgated by the Bureau of Internal Revenue for the guidance of either the taxpayers interested or the engineers whose duty it is to pass on these deductions. Thus amortization aggregating approximately $600,000,000 is allowed before there is any authoritative definition of the principles which are to be applied to its determination. This is a clear case of "locking the barn after the horse is stolen."

Redetermination of Steel Case Does Not Affect General Situations

Even though the United States Steel case is being redetermined, this redetermination does not affect the other large cases in which amortization was allowed on the same basis as in the United States Steel case.

The redetermination of the United States Steel case will not affect allowances made on the same basis, aggregating approximately $140,376,675.37, in cases in which a reassessment of tax is barred by the statute of limitations or by agreements under sections 1312 and 1006.

In addition to the allowances in the United States Steel case, allowances aggregating about $230,000,000 have been made in cases involving over $500,000 in which a reassessment is not barred by the statute. In some of these cases the right to redetermine amortization is doubtful by reason of the provision of the amortization statute limiting redeterminations to March 3, 1924.

Sound principles can be applied to cases not yet determined and in cases in which a redetermination was requested or initiated prior to March 3, 1924, but not yet made. This class of cases involves approximately $328,000,000. The application of sound principles to these cases will, however, constitute a gross discrimination against these particular taxpayers unless the whole subject is reopened.

The unsound allowances are largely confined to the larger cases. A redetermination of the cases involving allowances $250,000 and over will cover 95 per cent of the improper allowances, but will not involve the reconsideration of more than 289 cases.

The allowances for amortization for loss of value in use of facilities retained in use in all large cases are based upon principles which are so manifestly unsound and the failure of the Commissioner of Internal Revenue to publish any rules even suggesting that amortization would be allowed upon the basis applied in large cases is so discriminatory to smaller taxpayers that Congress should enact legislation requiring the reconsideration of at least the larger cases and clearly defining the principles applicable to the determination of proper deductions for amortization.

BUREAU METHOD OF DETERMINING VALUE IN USE OF FACILITIES RETAINED IN POSTWAR USE

Amortization for loss of useful value applies only to those facilities which have been retained in use by the taxpayer in his postwar business and does not involve allowances for facilities discarded or sold because they were not suitable or not needed for postwar operations. The propriety of the latter class of amortization allowances has not been questioned.

Amortization for loss of value in use as considered in this report does not include allowances to cover loss in value due to a lower postwar cost of replacing facilities acquired during the war.

Amortization for loss of value in use is based upon use only. It applies only to facilities retained in use and is distinct from the loss due to reduced cost of replacement.

It appears that prior to 1922 it was the policy of the amortization engineers to determine value in use, by determining the usefulness of war facilities in the regular postwar business of the taxpayer. The first engineering reports in the cases examined by the committee and its staff, made in 1920 and 1921, rejected claims for amortization for reduced value in use when the facilities were found to be actually in use in postwar operations.

DE LA MATER MANUAL

In November, 1922, S. N. De La Mater, then chief of the amortization section, prepared a "Manual of Amortization Section." This manual was never published for the information of taxpayers. It does not appear to have been approved by the commissioner. Inasmuch as the methods for determining amortization prescribed in this manual were later condemned by the solicitor, it is assumed that it was not submitted to the solicitor.

According to this manual the value in use of any particular facility acquired during the war is to be determined by comparing its average production during 1921, 1922, and 1923 with its maximum capacity for production.

If a facility is capable when used to full capacity every working day from January 1, 1921, to December 31, 1923, of producing 50,000 tons of product and the actual production during that period was 40,000 tons, such facility was considered to have an 80 per cent value in use. If the war cost of such facility was $100,000, but it could be replaced after the war for $80,000, the value in use is computed to be 80 per cent of $80,000, or $64,000, and the amortization is war cost $100,000 less $64,000, or $36,000.

The method prescribed by this manual of determining the amortization allowable on the war expenditure for facilities by determining the value in use of the particular facilities acqured during the war has only been applied in the smaller cases.

METHOD APPLIED TO LARGER CASES

The method generally applied, and always applied in the larger cases, has been to assume that the particular facilities acquired during the war period have the same value in use as the taxpayer's facilities generally regardless of comparative age or efficiency.

The method is to determine what per cent of the total capacity of the plant or department, consisting of both prewar and war facilities, is equal to the average production for the years 1921, 1922 and 1923. This per cent is assumed to be the per cent of value in use. In some cases this per cent is applied to the war cost, and in some cases it is applied to the postwar cost of reproduction to determine the value in use. The war cost, less the value in use, is the amortization allowed.

GROUPING OLD AND NEW FACILITIES FOR VALUE IN USE DETERMINATIONS IGNORES COMPARATIVE AGE AND EFFIENCY

This method of determining the value in use of facilities installed during the war by averaging the capacity and production of all of the taxpayer's facilities was condemned by Solicitor Hartson.

In his ruling in the J. J. Case Threshing Machine Co. case Solicitor Hartson says:

> In determining the value in use, it is necessary to determine such value as to the specific facilities erected or acquired for the production of articles contributing to the prosecution of the war.

In the same ruling he also says:

> Unless it be shown that after the amortization period the war facilities were to a certain extent not needed, no reduction in value in terms of use is shown.

This ruling of Solicitor Hartson is modified by the ruling of Solicitor Gregg in the United States Steel Corporation case, in which he says:

> It is realized by this office that in many cases it is impracticable, because of the exceedingly large number of facilities involved and because of the absence of proper records as to such facilities, to make an examination and and comparison of each specific facility; but such examination should be made wherever practical. The more often the examination and comparison can be made of individual facilities the more nearly accurate will be the determination

of value in use. Where the examination of the individual facilities is not practicable the examination should be made by groups of machines or by departments of the business in accordance with the following general method.

That Solicitor Gregg realizes that the usefulness of a facility installed during the war may not be represented by the average use of all of a taxpayer's facilities is shown by the following quotation from his ruling in the United States Steel case.

Where the amortized facilities are in postwar use in connection with similar pre-war units, if records are obtainable of the actual amount of use given to each of the groups, the value in use of the amortizable items should be based upon the actual amount of use received by them. If such records are not available, and the value of the amortizable items has to be based on the total amount of use given both groups combined, a decision should be reached as to whether the amortizable items are in better condition, or capable of more economical operation to such a degree that their value in use is greater than that of the older prewar units, and if such is found to be the case, their value in use should be ascertained accordingly.

All of the taxpayers to whom the larger allowances for amortization were made were going concerns before the war. They all had facilities of age and condition varying from practically new to scrap. There was no attempt made in any of the larger cases to determine the actual usefulness or comparative remaining useful life of the facilities amortized for loss of useful value.

It was contended by the bureau that in the larger cases the segregation of the facilities amortized and the determination of the usefulness of those particular facilities was impracticable. (1084.) It is clear that a taxpayer claiming the right to a deduction for loss of value in use should be required to assume the burden of proof and show to the satisfaction of the commissioner the facts necessary to sustain his claim.

Solicitor Gregg's ruling actually means that where a taxpayer is unable to show the use of a particular facility upon which amortization is claimed a method which he recognizes as unsound may be used to determine the amortization allowable.

The amortization allowances to the Berwind-White Coal Mining Co. and to the Firestone Tire Co. are excellent illustrations of the fallacious results obtained by mingling old and new facilities for the purpose of determining value in use by this ratio of production to capacity method.

The Berwind-White Coal Mining Co.
(745)

This company installed a new power plant at its mine during the war upon which it was allowed amortization amounting to $373,401.12, based upon loss of value in use of 47.4 per cent.

The pre-war facilities of this taxpayer consisted of three power plants, containing several generators of varying sizes and ages, aggregating 9,000 kilowatts capacity. The war plant was a modern plant consisting of two 5,000-kilowatt generators, or a total capacity of 10,000 kilowatts. The war plant went into operation immediately upon completion and has been operated continuously ever since. The connected peak load of the war plant was within 500 kilowatts of its capacity, and as the demand for current was increasing at the rate of about 450 kilowatts per year the full capacity of the war plant has now been absorbed.

Soon after the completion of the war plant this taxpayer determined that the old pre-war plant could not be efficiently maintained, even as a reserve. The pre-war plant was written off the taxpayer's books, and the residual value in the pre-war plant was taken as a deduction from the taxable income of 1920. In 1920 an additional 10,000-kilowatt generator was acquired and installed in the war plant as a reserve unit.

The war plant was determined to have a value in use of only 52.6 per cent, on the theory that combining the capacity of the old pre-war plant with the capacity of the war plant the company had a capacity of 19,000 kilowatts, or 47.4 per cent more than it then needed.

When this determination was made the company had already abandoned the old plant and had acquired the postwar plant. Although this taxpayer had, by abandoning the old plant, determined that it had no value in its postwar business, the income tax unit method of determining value in use gave this abandoned plant the same value in use as the new war plant, thus reducing the value in use of the war plant.

When an old facility is supplanted by a newer facility, the only capital loss to be written off the capital account is the residual undepreciated value of the old facility. This taxpayer was permitted to deduct from the 1920 income the difference between the amount at which the old plant was carried in capital account and its scrap value. That deduction wiped the old plant out of existence for income-tax purposes. Yet, after permitting this deduction eliminating the old plant in determining amortization, the old plant was considered to still be properly chargeable to capital at the same useful value as the war plant.

Thus, although this war plant was the only plant owned by the taxpayer which could be economically operated, and was in full use to 95 per cent of its rated capacity, and although its full rated capacity would be reached in one year, it was considered to be surplus capacity and to represent a loss to the extent of 47.4 per cent of its cost, because the company had on the scrap pile, charged to scrap, a collection of antiquated plants which could not be economically operated.

FIRESTONE TIRE CO.

This taxpayer was allowed amortization for loss of value in use amounting to $1,464,983.73, in addition to amortization upon discarded facilities amounting to $551,210.57. The propriety of the allowance upon discarded facilities is not questioned.

Among the facilities amortized for reduced value in use was plant II. This plant cost $2,551,974.59. It was held by the engineer to have a value in use of 78 per cent. This value in use was later reduced, as the result of a conference with the taxpayer, to 74 per cent. This determination meant that the taxpayer had use for but 74 per cent of the capacity of this plant, and therefore 26 per cent of the cost, or $663,513.39, was a capital loss properly amortizable as an expense of the war period.

The facts with refernce to the taxpayer's postwar use of this plant are set forth in the report of the income tax unit engineer, who made this allowance, as follows:

This is a new and fully equipped plant erected in 1917 and 1918. It is equipped for the manufacture of the smaller sizes of tires. As a unit for the production of these it did not come into full use during the war, but was used for other war work, as previously explained. At the time of the engineer's visit this plant was in use to practically full capacity, two shifts a day, and it is reasonable to suppose that approximately similar conditions have existed in the past and will exist in the future during the busy season.

These conditions indicate that the floor space in this plant is somewhat in excess of the present needs. On the other hand, it must be considered that this plant is busy for two shifts out of three each day during the busy season. It is not contended that the building is as full of machinery as might be possible, but it is believed that it is nearly as full as is practicable if it is desired to have a light, clean, well-ventilated plant. It may not be necessary to store tires or rubber in the building, but it is a convenience, and conveniences have a value.

On one point there is no doubt. Plant II is a permanent improvement. It may have unused capacity for one-third of the time, but it is a well-equipped and laid-out piece of machinery for manufacturing fabric tires. The handling costs are kept at a minimum, and as compared with plant I it shows the difference between a plant which has been designed for a definite purpose with the experience of a number of years behind it and a plant which has grown up by additions and rearrangements through a number of years. The taxpayer has applied a general activity ratio to this facility as a whole and has further that both plants Nos. 1 and 2 be treated as a whole. This method of application is conceded to be reasonable, and an amortization of 22 per cent of cost is recommended on the total cost of plant No. 2.

It will be noted that notwithstanding the fact that it was necessary to operate this plant double time to meet the demand for production 26 per cent of the capacity of this plant was determined by this method to be a useless surplus of capacity.

One of the most expensive and most important machines used in the manufacture of rubber is what is known as a massing machine. This machine is used to mix old and new rubber into one mass. Prior to the war this taxpayer had 55 of these machines. During the war period 21 massing machines were added, and after the war the taxpayer installed 18 more. The 21 machines were held to have a postwar value in use of 74 per cent. Thus by the bureau method five of the machines installed during the war were held to constitute valueless surplus capacity, notwithstanding the fact that this taxpayer by the purchase of the postwar machines had determined that its business required not only the full war installation but 18 additional machines.

It will be noted that the allowances in these cases are condemned by the rulings of both Solicitor Hartson and Solicitor Gregg, yet neither these cases nor allowances made in many other cases under similar circumstances where war facilities are in use to their full capacity and the war capacity has been increased by postwar additions are effected by the reconsideration of the United States Steel case.

M'KEESPORT TIN PLATE CO.

The discrimination between taxpayers, which results from the determination of value in use on the basis of the postwar use of the specific facility in some cases and on the basis of the average of the capacity of old and new facilities in other cases, is clearly brought out by a comparison of the determination of the Berwind-White case and the case of the McKeesport Tin Plate Co.

During the war period the McKeesport Tin Plate Co. installed a new boiler plant consisting of 12 boilers. The old pre-war boiler plant was obsolete and was retired from use as the new plant was completed. Thus, their situation was identical with that of the Berwind-White Co. All of these boilers were used in rotation, but the income tax unit determined that the postwar business of the taxpayer required only nine boilers and that the postwar value in use of the plant was 78⅓ per cent. This determination was made by comparing the capacity required with the total capacity of the new war plant. Had the method followed in the Berwind-White case been applied to this case, the required capacity would have been divided by the combined capacity of the old and new plants instead of by the capacity of the new plant alone. Had the method used in the Berwind-White case been applied to this case the value in use would have been about 43 per cent instead of 78⅓ per cent. This difference in value in use amounts to about $1,000,000 in amortization.

The comparison of these two similar cases shows the vast difference in the amortization resulting from the application of different methods to taxpayers similarly situated.

The value in use in the McKeesport case was later reduced to 72½ per cent, but this was the result of a compromise agreement and not the result of any engineering computation.

The method of handling the McKeesport case was not the result of a change of policy, as this determination was first made prior to the allowance in the Berwind-White case and the case was reconsidered and affirmed subsequent to the determination in the Berwind-White case.

PRESENT USE DOES NOT MEASURE FUTURE USEFULNESS

While the ruling of Solicitor Gregg that the comparative condition and efficiency of facilities grouped for amortization purposes must be considered very clearly covers such cases as the Berwind-White case, it is not clear that this ruling gives any consideration to future usefulness.

The full value of a present excess of capacity may be realized when capacity is reduced by the retirement of pre-war units or through the future growth of the business.

One of the questions submitted to Solicitor Gregg in the United States Steel case was as follows:

> In the determination of value in use should the period March 3, 1921, to March 3, 1924, be taken as indicative of normal postwar conditions, or should conditions either prior or subsequent to that period be given consideration?

In reply to this question Solicitor Gregg says:

> Since the final date for the ending of the war was fixed by congressional resolution as March 3, 1921, the postwar period for amortization purposes began on March 3, 1921, and ended on March 3, 1924. It is clear that the value in use of a facility does not depend upon the use to which it is put on any given day, but should be arrived at by a consideration of the use of the facility over a period of time. It is therefore the opinion of this office that as a general rule the average use given to a facility over the period from March 3, 1921, to March 3, 1924, is indicative of the value in use of such facility. However, where evidence exists that any one of these years, such for instance, as the

year 1921, is manifestly not indicative of normal postwar conditions, the use of the facility during such year may be disregarded and the average of the remainder of the period may be taken.

After stating that the comparative condition and efficiency of pre-war and war facilities must receive consideration, this ruling says (italics ours):

If, on the other hand, it is satisfactorily proven that the taxpayer has ample pre-war facilities for all of its postwar commercial requirements of equal efficiency to those required for war work, consideration should be given this factor in ascertaining the value in use of the amortized facilities. *In all such cases the extent to which facilities are in use shall be considered substantial proof that the value of their use is in direct proportion to the amount of use given them unless it is definitely established that such use has a lower or higher value by reason of the peculiar conditions in individual cases.*

In all the value in use determinations which have been made the future use or usefulness of amortized facilities has been completely ignored. Solicitor Gregg's ruling makes no mention of future use or usefulness as an element of value to be considered. The above quotations from his ruling strongly indicate that use during the period March 3, 1921, to March 3, 1924, is the basic factor to be considered in determining value in use, and while he states that present condition and efficiency are to be considered he does not state that comparative life or future usefulness are to be considered, or how a determination of value in use is to be modified by comparative life and future usefulness if these elements of value are considered.

The following hypothetical case illustrates a situation common to most of the larger allowances.

Assume a taxpayer had five blast furnaces on April 6, 1917, the respective ages of which were 19, 16, 13, 10, and 8 years, each of which had an annual capacity of 125,000 tons. The total capacity of the five furnaces is 625,000 tons. Assume that the useful life of such a furnace is 20 years.

In 1918 the oldest furnace reaches the end of its useful life and is replaced by a new furnace which cost $1,000,000. We will assume that at the close of the war period this furnace had been just completed and went into operation with a useful life of 20 years ahead of it, during which time it can produce 2,500,000 tons. At the same time pre-war furnaces have, respectively, 3, 6, 9, and 11 years of useful life ahead of them. If the pre-war capacity is to be maintained, it will be necessary to rebuild furnace No. 2 in 1921, furnace No. 3 in 1924, furnace No. 4 in 1927, and furnace No. 5 in 1929. During the remainder of their useful lives No. 1 can produce 375,000 tons, No. 2 can produce 750,000 tons, No. 3 can produce 1,125,000 tons, and No. 5 can produce 1,375,000 tons.

At the close of the war period this taxpayer has an annual capacity of 625,000 tons, but in 1921 the production is only 300,000 tons, in 1922 it is 400,000 tons, and in 1923 it is 600,000 tons. The total production for the three years is 1,300,000 tons and the average annual production is 433,333 tons. The average annual production for 1921, 1922, and 1923 is thus 69.3 per cent of the annual capacity at the close of the war. According to the method generally used, a furnace built during the war is thus determined to have a value in use of 69.3 per cent. If value in use is based on war cost, the value in use is 69.3 per cent of $1,000,000 and the amortization is $307,000.

If value in use based on postwar cost of reproduction, the value in use is 69.3 per cent of $800,000, or $554,400, and the amortization is the difference between $554,400 and $1,000,000, or $445,600.

It will be noted that by this method no greater value is attributed to a new furnace capable of producing 2,500,000 tons during the remainder of its useful life than is attributed to the oldest furnace capable of producing only 375,000 tons during the remainder of its useful life, although the new facility will actually be capable of 66.6 times as much use as the old facility during the balance of its useful life.

It will be noted that the taxpayer is assumed to have a required capacity of only 433,333 tons, with which it could not produce the 600,000-ton production of 1923.

If the year 1921 is eliminated, as Mr. Gregg states it should be, if it is abnormal, averaging production of 1922 and 1923 will give a required capacity of 500,000 tons and a value in use of 80 per cent. A capacity of 500,000 tons will not produce the product of 1923.

It will be noted that the construction of this furnace merely maintained and did not increase the taxpayer's pre-war capacity.

It will be noted if the taxpayer does not rebuild the furnace which will reach the end of its useful life in 1921 his capacity will be down to 500,000 tons in 1921, and if he does not rebuild the furnace which will reach the end of its useful life in 1924 his capacity, including the new furnace, will be down to 375,000 tons in 1924.

If there is postwar construction, any excess of capacity will be due to that instead of to the building of the war furnace. If there is no postwar construction, the war facility will be the only furnace fit for use by 1929. It is clear that there is no capital loss in this case, although there may be a loss of income due to a premature investment.

This hypothetical case is typical of the cases in which the bulk of all allowances for loss of useful value have been made, and it is not clear that even under Solicitor Gregg's ruling in the United States Steel case amortization for loss of useful value would not be allowable in such a case, even though there is actually no capital loss.

As has been said, the typical case is that of a taxpayer having a plant or plants with facilties of various ages and states of efficiency. At the close of the war period the war installations were the newest, the least effected by age and wear, the most modern, and the most highly efficient. Facilities with but one year of remaining useful life, and which can not be economically operated except during periods of high prices, are, however, figured into annual capacity, and any method of determining value in use by comparing capacity with production gives no more value in use to a facility with 20 years of useful life ahead of it than is given to facilities which are hovering on the edge of the scrap pile. Likewise, facilities which are so antiquated or inadequate that they can not be efficiently operated are given the same value in use as those which are the last word in labor and power saving efficiency.

In practically every case, the replacement of old, inefficient facilities by new, larger, and more efficient equipment is constantly going on in the regular normal peace-time business of these taxpayers.

Some of this renewal is due to inadequacy of size, some to age and wear, and some to inefficiency of operation. An examination of every large amortization allowance fails to show a single case, where amortization was allowed for loss of value in use because of an excess number of units, in which the facilities, held to constitute a valueless surplus of capacity, would not be sooner or later absorbed as replacements.

INDISPENSABLE FACILITIES

The bureau method of determining value in use allows amortization for lack of use on facilities which may be indispensable to the taxpayer's business.

The Morse Dry Dock & Repair Co. claimed amortization on a dry dock and based its claim on reduced replacement cost. The taxpayer showed that the United States Shipping Board was offering dry docks for sale, and claimed the difference between the cost of its dock and the amount for which a similar dock could be purchased. This claim was rejected and amortization was allowed based upon reduced value in use.

The value in use in this case was based upon a combined ratio of tonnage docked and days employed to the capacity.

This taxpayer was unquestionably entitled to amortize the difference between the war cost of this dock and its postwar cost of replacement, but there could be no such thing as loss of use in this case, because it takes a whole dock to lift a ship, and the business could not be conducted with any less than one dock, and a smaller dock would not lift the ships for which this dock was used.

A hypothetical case will illustrate a situation common to many cases where amortization for loss of use has been allowed.

Work can not be done on half a lathe. The business of A requires the use of a lathe about half of the time. A finds that in sending the work out to be done he is paying a profit to B, and is required to pay for transporting his materials to and from B's plant. The work is not done under A's supervision and is not always done exactly when required. A determines that even though he can not use this lathe to more than 50 per cent of its capacity, it will be a profitable investment. If the income tax unit engineers determine that they will measure the value in use of this facility by the ratio of the production to the capacity of this particular facility, they would attribute to it a value in use of 50 per cent and allow amortization of 50 per cent on loss of value in use.

In his ruling in the United States Steel case, Solicitor Gregg says:

> If any items are found to have individual values distinctly different from that of the department or plant, the values of such items should be determined separately. Particular attention should be given to such items as may reasonably be considered to be indispensable in the operation of the plant, even though only occasionally used, and if it is found that the taxpayer's normal business, regardless of its actual volume, requires such facilities, no amortization should be allowed on such items except on the basis of lower replacement costs.

The rule stated by Solicitor Gregg has not been observed in any case, and illegal allowances in such cases are not affected by the reconsideration of the United States Steel case.

OVERSIZE UNITS

Many claims for amortization for loss of use are based upon the excess capacity of single units for postwar operation. Buildings constructed for war purposes are frequently of greater capacity than required for postwar operations. In such cases the taxpayer can not discard the excess capacity as he can an excess number of units.

The practice of the bureau in such cases has been to base the amortization upon the ratio of capacity to capacity required for postwar operation. Thus, if but two floors of a four-story building are required for postwar use, 50 per cent of the cost is amortized. This method ignores the fact that building cost does not increase in proportion to capacity. It may require as much excavation, foundation, and roofing for a two-story building as for a four-story building.

In his ruling in the United States Steel case, Solicitor Gregg says:

> The value in use of amortized facilities to the taxpayer in its going business in the case of individual items is in general best reflected by the depreciated normal postwar cost of similar facilities of the proper size or capacity for meeting the requirements of the taxpayer's postwar commercial business during and for the term of years the facility under reconsideration may reasonably be expected to function efficiently.

This rule is undoubtedly sound. Applying it to the case of a building of excess capacity, the amortization is the difference between the cost of the oversize building and the postwar cost of a building of size adequate to meet the taxpayer's needs, plus an allowance for expansion of his business.

Examples of allowances made by the bureau on excess postwar floor space of buildings, instead of on differences between war cost and replacement cost of a building of proper size for postwar business, may be found in the following cases: American Shell Co., Bauer & Black, Bausch & Lomb Optical Co., Buda Co., E. I. du Pont de Nemours Co.

An excellent example of an oversized unit improperly handled by the bureau, and not in accordance with the solicitor's ruling above, may be found in connection with a 3,000,000-cubic-foot stack and gas treating plant in the case of the Anaconda Copper Mining Co.

IRREGULARITY OF PRODUCTION REQUIRES CAPACITY ABOVE AVERAGE TO PRODUCE ACTUAL PRODUCTION

The method followed by the income tax unit of measuring the value in use of the taxpayer's facilities by the ratio of capacity to production assumes that a facility is not worth its postwar cost of replacement to the taxpayer unless its production is 100 per cent of capacity, 100 per cent of the time from March 3, 1921, to March 3, 1924. Using the ratio of average production for any period to capacity as the ratio of value to cost or cost of replacement has the effect of requiring 100 per cent production to give 100 per cent value.

There is no industry which does not have some months in which production does not exceed the production of other months, and there is no industry which does not experience some dull years. The industrial history of this and every other country shows regular cycles of rise and fall in industrial production, and the production of good years could not be produced with a capacity equal to the average production of good and bad years, nor can the actual production of any year be produced with a capacity equal to that production, unless month-to-month production is constant.

The fallacy of the theory, that required plant capacity equals the average annual production of 1921, 1922, and 1923, can be demonstrated by a hypothetical case based upon the actual production of steel ingots in the United States during those years. It may be reasonably assumed that the variations in the monthly and annual production of any large steel plant will follow very closely the variation in the total production.

We will assume a plant with a capacity and production proportionate to the total production of steel in the United States.

The tonnage of steel ingots produced in the United States during each month of 1921, 1922, and 1923, the total annual production, and the average per month is shown by the following table. The figures are taken from the "Survey of Current Business," Department of Commerce.

Production of steel ingots

(Gross tons)

	1921	1922	1923		1921	1922	1923
January	2, 517, 042	1, 891, 857	3, 822, 369	September	1, 342, 092	2, 818, 261	3, 328, [illegible]80
February	1, 998, 705	2, 071, 772	3, 454, 918	October	1, 847, 139	3, 410, 265	3, 547, 966
March	1, 794, 777	2, 814, 667	4, 046, 854	November	1, 896, 483	3, 430, 309	3, 113, 804
April	1, 386, 897	2, 902, 240	3, 944, 412	December	1, 630, 395	3, 300, 416	2, 843, 764
May	1, 446, 181	3, 218, 794	4, 195, 800				
June	1, 146, 350	3, 127, 775	3, 748, 890	Total	19, 224, 084	34, 568, 418	13, 239, 369
July	917, 824	2, 952, 808	3, 514, 241				
August	1, 300, 199	2, 629, 256	3, 677, 771	Monthly average	1, 602, 007	2, 880, 702	3, 603, 281

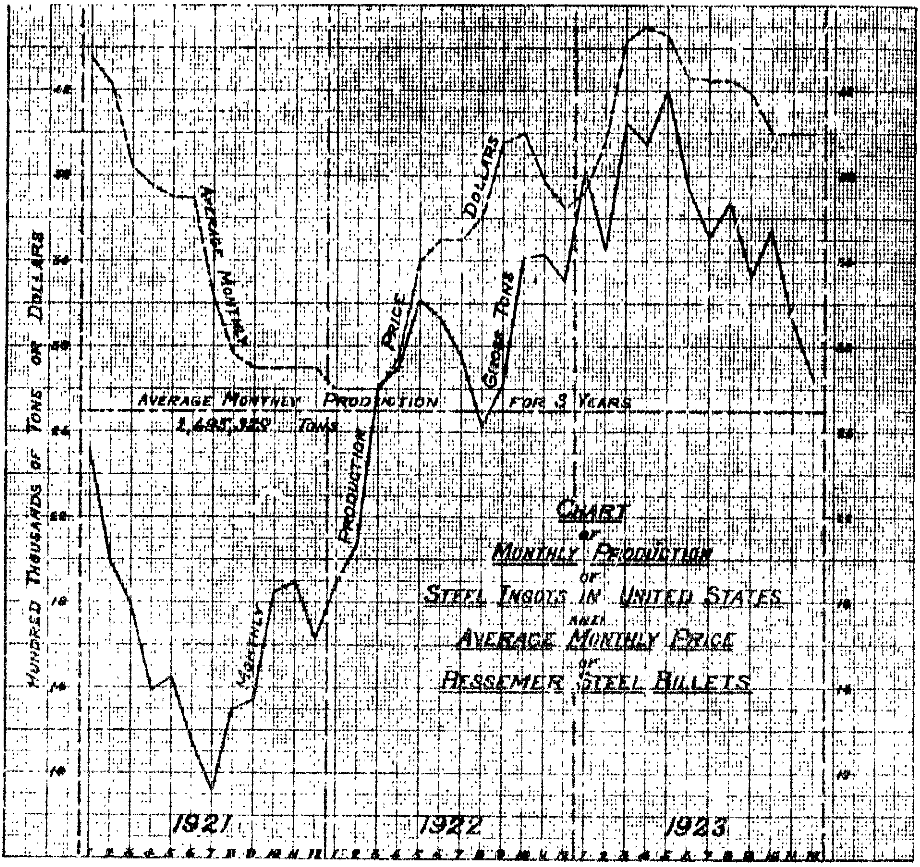
Total production 1921, 1922 and 1923	97, 031, 871
Average annual production 1921, 1922 and 1923	32, 343, 957
Average monthly production 1921, 1922 and 1923	2, 695, 330

In this hypothetical case we will assume that there has been no postwar construction, and that all of the facilities in use in 1923 are pre-war and war facilities. As this plant actually produced 4,195,800 tons in May, 1923, its annual capacity must be 12 times the May production or 50,349,600 tons. The average annual production for 1921, 1922, and 1923 is 32,343,957 tons, which is 64.2 per cent of the assumed annual capacity. The value in use of the facilities is thus determined by the bureau method to be 64.2 per cent of cost or postwar cost of reproduction, depending upon which basis is used.

It will be observed that all capacity in excess of 32,343,957 tons per annum is considered to be of no value, and to represent an amortizable loss. An annual capacity of 32,343,957 tons is equal to a monthly capacity of 2,695,330 tons.

By referring to the above table it will be seen that the production of nine months of 1922, and of every month in 1923, exceeded the assumed required monthly capacity of 2,695,330, and that the production of those years could not have been produced with such assumed required capacity. It will also be noted that even had it been possible to delay the filling of orders for a few months the assumed required capacity would have been inadequate, because after production first passed this assumed required capacity, in March, 1922; it fell below it in only one month, August, 1922. It will be seen that to have attained the actual production, the average of which is made the basis of this estimate of required capacity, it would have been necessary to have produced 37,734,620 tons during the 14 months from January, 1921, to February, 1922, inclusive, instead of the 23.187,713 tons actually produced, and to have carried 14,546,907 tons in stock in anticipation of the 1923 demand, when it was not known that such demand would arise.

In 1923, the production was 43.239,369 tons. An annual capacity of 43, 239,369 tons could not have produced this amount of product,



unless the production of every month was equal. An annual capacity of 43.239.369 tons is equal to a monthly capacity of 3,603,281 tons. But to produce the tonnage which was produced in 1923 it was necessary to have a capacity in excess of 3,603,281 tons during six months of 1923, and a monthly capacity in excess of 4,000,000 tons, during March and May, 1923. The actual production of 1923, amounting to 43.239,369 tons, could not have been produced as it was produced without an annual capacity of 50,349,600 tons. Yet, this method would determine 35.8 per cent of a plant with that capacity to be an amortizable loss

Actual examples of the above, some of which will be discussed hereinafter, may be found in the following cases, in addition to the

United States Steel case: Aluminum Co. of America, Air Reduction Co., American Clay Machinery Co., Anaconda Copper Co., Brown & Sharpe Manufacturing Co., United Verde Extension Mining Co.

AVERAGE PRODUCTION METHOD IGNORES REQUIREMENTS OF PEAK PERIODS

There is a limit to the period of time customers will wait for the filling of orders, and unless capacity is available when orders come, business is lost. Profits are greatest when demand exceeds supply, and the excess capacity, available for participation in the large profits of peak periods, can not be said to represent a capital loss, as it is determined to be by the bureau method. The chart on the oposite page shows graphically the relationship of production and prices in the steel industry, and the extent, to which a plant, with a capacity limited to average production, would be barred from participating in the most profitable production.

This method ignores the basic principles upon which manufacturing industries are conducted. By assuming that all excess of capacity over the average of 1921, 1922 and 1923 represents capital loss, the bureau method assumes that the excess capacity of 1921 would be utilized to manufacture products which could not be sold until 1923. Manufacturing business is not ordinarily conducted on any such basis. It is found to be better business policy to carry facilities capable of producing the product when it is required, than to tie up a vastly greater amount of capital in finished stock which may never be sold.

Cases presented to this committee, which will be hereinafter reviewed, show that even during the postwar years there has been the widest variation in the annual production of claimants for amortization for loss of value in use.

ALUMINUM COMPANY OF AMERICA

Production figures furnished by the Aluminum Co. of America are as follows (1820):

Year	Pounds of aluminum produced	Year	Pounds of aluminum produced
1919	128,461,052	1922	73,632,867
1920	137,930,208	1923	128,658,222
1921	54,531,996		

This taxpayer's allowance of amortization for loss of value in use was based upon the assumption that its capacity in excess of 82,000,000 pounds represented a loss. It will be noted that the assumed required capacity, which is made the basis of the amortization allowance in this case, would produce less than 64 per cent of the actual porduction in 1919 and 1923, and less than 60 per cent of the actual production of 1920.

The income tax unit found this taxpayer's capacity to be 146,000,000 pounds. Its capacity only exceeded its 1920 production by 6 per cent and its 1919 and 1923 production by 12 per cent. During the pre-war period this company had carrier excess of capacity over production to meet the irregularity of demand of 35.34 per cent in

1915, 22.89 per cent in 1916 and 25.22 per cent in 1917. It will be noted that the excess of capacity over production in 1919, 1920, and 1923 was less than found necessary during the pre-war period, and made no provision for the future demand of a business which had more than doubled in volume between 1915 and 1923.

Although this company had a lower percentage of excess capacity over the production of three out of the five postwar years, than it had carried during the pre-war period, the income tax unit held that its 146,000,000 pound capacity only had value in use of 56 per cent, and amortization of 44 per cent was allowed on capital plant charges of $23,737,000. The allowance for amortization of facilities, actually retained in use by this taxpayer for its postwar business amounts to $10,444,280.

UNITED STATES STEEL CORPORATION

The United States Steel Corporation subsidiaries were allowed amortization amounting to $55,063,312.60, of which $27,926,014.01 was for loss of value in use of facilities retained in use. This allowance for loss of value in use made a difference in tax of $21,438,513.69. The balance of the allowance was for discarded facilities and for difference between cost and postwar cost of reproduction and is not questioned.

The allowance of amortization for loss of value in use is based upon a determination that approximately 20 per cent of this taxpayer's capacity for steel production was surplus produced by war extensions which was of no value in its postwar business.

It was conceded by the taxpayer that it required some surplus capacity over production. This required surplus was assumed by the taxpayer to be the average surplus of capacity over production during the years 1910 to 1915, inclusive. The per cent of surplus capacity conceded to be required was 31.4 per cent for pig iron facilities, 25.4 per cent for steel ingot facilities, 24.2 per cent for billets, blooms, and slabs, and 17.4 per cent for rolled and finished steel.

The 1921 capacity was used as the basis for determining the amortization allowance, notwithstanding the fact that large capital expenditures in 1919 and 1920 had increased the capacity beyond that created by amortized war additions. The value in use was computed by the income tax unit as follows:

	Pig iron, (tons)	Steel ingots, (tons)	Billets, blooms and slabs (tons)
1921 production	8,678,262	10,951,856	8,861,616
1922 estimated production	11,080,384	15,19[illegible],030	12,350,000
1923 estimated production	14,149,649	16,967,111	13,800,000
Total	33,908,295	43,110,000	35,011,616
Average	11,302,765	14,370,000	11,670,539
Average ratio capacity to production (per cent)	[1] 131.3	125.5	124.2
Necessary postwar capacity	14,840,530	18,002,300	14,494,809
1921 capacity	18,499,340	22,502,900	17,900,815
Value in use = 1921 capacity ÷ necessary postwar capacity (per cent)	80	80	81

[1] Error in calculation, should be 131.4.

It will be noted that the production upon which this determination was made was estimated for 1922 and 1923. This amortization determination had not left the engineering division, to be applied by the auditors in determining the tax, on January 24, 1924, when the actual production for 1922 and 1923 was known, and was known to be far in excess of the estimates used. Notwithstanding the fact that it was then known that the estimated production was too low an agreement was made with the taxpayer not to reopen this determination and substitute the actual production figures. (1205.) (See also solicitor's memorandum 4225 and page 1162 of hearings).

Had actual production, then known, instead of estimated production, been used, the same method of determining value in use would show the following results. (1162.)

	Pig iron (tons)	Steel ingots (tons)	Billets, blooms and slabs (tons)	Rolled and finished steel (tons)
1921 production	8,678,202	10,951,856	8,861,616	7,860,334
1922 production	12,027,173	16,034,599	15,348,949	11,785,331
1923 production	16,729,226	20,297,666	18,642,065	14,721,469
Total	37,434,651	47,284,112	42,852,630	34,367,134
Average	12,478,217	15,761,371	14,284,210	11,455,711
Average ratio capacity to production, 1910-1915	1.314	1.254	1.261	1.274
Necessary postwar capacity	16,436,377	19,764,759	18,012,389	14,594,576
1921 capacity	18,490,340	22,502,900	17,900,815	16,562,892
Value in use (per cent)	88	88	100.6	88.1

Thus the use of actual instead of estimated production would have barred amortization on billet, bloom and slab facilities and would have decreased the allowance on other facilities 40 per cent.

During the pre-war period, 1910 to 1915, inclusive, pig iron capacity averaged 131.4 per cent of production and during no year was less than 113.7 per cent of production The 1921 pig iron capacity was only 109.7 per cent of 1923 production.

During the same pre-war period steel ingot capacity averaged 125.4 per cent of production and was never lower than 110.8 per cent of production.

The 1921 steel ingot capacity was 110.7 per cent of the 1923 production.

The 1910 to 1915 capacity for the production of billets, blooms, and slabs averaged 124.2 per cent of production and was never lower than 104.5 per cent of production.

The 1910 to 1915 capacity averaged 127.4 per cent of the production of rolled and finished steel and was never lower than 111.1 per cent of production. The 1921 capacity was 112.5 per cent of the 1923 production.

During the years 1919 and 1920 this taxpayer expended $190,047,647 for capital plant charges, which must have made some increase in its capacity over the capacity produced by war expenditures. (1205.) By using 1921 capacity as the basis of determining whether the war expenditures produced a useless excess of capacity, the excess created by postwar expenditures is thrown back into the war years, but even assuming all of the 1921 capacity as due to war expenditures, we find that in 1923 the margin of excess of capacity over production was nowhere near the pre-war average and was less even than the pre-war minimum. Notwithstanding this fact the income tax unit determined that 20 per cent of this taxpayer's facilities were a useless excess representing a capital loss

MARGIN OF CAPACITY REQUIRED TO MEET NORMAL EXPANSION OF GROWING BUSINESS

It is the policy of most manufacturers to try to keep their capacity ahead of current demands for production to enable them to take advantage of opportunities to expand their business. No competent management of a growing business which is required to construct a new plant would fail to look a few years ahead and install a plant of sufficient capacity to meet the demand which can be anticipated for a reasonable future period.

The Income Tax Unit method of measuring useful value, by average production in 1921, 1922 and 1923, not only ignores the fact that the capacity required to meet the peak demands within that period has a value, but determines surplus capacity which will be absorbed by the growing demand of a growing business to have no value.

AIR REDUCTION CO.

The Air Reduction Co., manufacturers of oxygen and acteylene gas, was allowed amortization amounting to $887,098.64, of which $533,623.18 was to cover reduced post war cost of replacement, and $353,475.46 was for loss of value in use in addition to reduced cost of replacement.

The following table shows the rated capacity used in determining the value in use of seven of this company's plants, the actual production during the post war years designated, the ratio of production to capacity during those years and the per cent of value in use determined as the basis of amortization.

Plant	Year	Rated war-time capacity	Production	Production per cent of rated capacity	Per cent used by engineer
		Cubic feet			
Buffalo	1923	15,120,000	15,120,000	100	94.5
Chicago	1920	28,645,000	29,620,665	104.4	96.1
Chicago	1923	30,240,000	32,087,030	106.1	96.1
Minneapolis	1923	15,120,000	15,120,000	100	85.0
Philadelphia	1923	57,120,000	57,489,800	100.6	79.5
Richmond	1923	16,800,000	16,737,080	99.6	85.5
Seattle	1923	16,800,000	16,750,125	99.7	68.4

From the above it will be seen that in 1923 the actual production of 7 of the 10 plants was either approximately equal to or greater than the rated war-time capacity and in 1920 the production of the Chicago plant was 103.4 per cent of the rated capacity, whereas the engineer has, by averaging the production of the postwar years, arrived at a much lower percentage upon which he basis amortization.

If we average the above production, capacity, and percentage figures we find that the average production was 101.3 per cent of capacity of the seven plants. Further, we find that the average percentage, as used by the engineer, is 86.4 per cent, or 14.9 per cent lower than the average rated war-time capacity. This would mean that, if the theory upon which the engineer bases his computation is correct, the taxpayer could not have produced its 1923 output, without having its facilities 100 per cent in use, which would have precluded the allowance of any amortization.

Many similar cases in which capacity required for 1923 production has been considered a capital loss are included in the summary of amortization cases in the appendix of this report.

SALVAGE OR SCRAP VALUE IGNORED

Another fundamental defect in this method of determining value in use is the fact that it completely ignores the salvage or scrap value of facilities retained in use.

Where a facility has a salvage or a scrap value, the loss, which the taxpayer may bear, can not exceed the difference between the cost and the salvage or scrap value.

The regulations provides that value in use shall not be less than salvage or scrap value. It is manifest that any facility which is held in use by the taxpayer must have a value to him in excess of the salvage or scrap value. The salvage or scrap value can be realized by selling the facility, and if a facility is retained for use, it must be retained, because it is considered to have greater value in use, than the amount for which it can be sold.

When the per cent of value in use has been determined, it is applied to the entire cost or cost of replacement, to determine the value in use. Thus, amortization is allowed upon the residual scrap value, to the same extent that it is allowed upon that portion of the cost, which is recoverable by use.

Suppose that a taxpayer purchased 100 cars during the war at $1,500 per car. Assume that these cars can be replaced new after the war at $1,200 per car, but that used cars could be sold for $600 per car.

Due to reduced cost of replacement this taxpayer has sustained a loss of $300 per car or $30,000 on the 100 cars.

The Income Tax Unit finds that these cars are 75 per cent in use, and therefore determines that the value in use is 75 per cent of $120,000 or $90,000, and the amortization is the war cost $150,000 less $90,000, or $60,000.

Now if the cars are 75 per cent in use, the work can be done with 75 cars, and the taxpayer can sell the remaining 25 cars for $600 per car. After taking amortization for $60,000, the taxpayer sells 25 cars at $600 and receives $15,000, which now reduces his investment in cars to $75,000. He now has 75 cars in full use, capitalized for income tax purposes at $75,000, but the postwar cost of replacing 75 cars is $90,000. This example proves that his amortization allowance is excessive by $15,000, which is the salvage value of the cars.

Assume that instead of keeping 100 cars in use this taxpayer had discarded the 25 cars he did not need. The regulations allow a taxpayer on discarded facilities the difference between cost and salvage value. The 25 cars cost $1,500 a car, or $37,500. The salvage value is $600 per car or $15,000. Thus on the discarded cars $22,500 of amortization is allowable. On the 75 cars retained in 100 per cent use the taxpayer receives the difference between war cost, $112,500, and post war cost of replacement, $90,000, or $22,500. His total allowance for amortization is thus $45,000 if he discards the unnecessary cars, and $60,000 if he keeps them.

Thus a taxpayer who retains surplus facilities in use instead of discarding them receives additional amortization equal to the salvage or scrap value of all the facilities upon which amortization is figured, and he also has the use of such surplus to meet peak demands, to replace other facilities, to retard depreciation, and to meet the demands of business expansion.

Cases illustrating the above point may be found in the allowances to the following companies: Buda Co., Brown & Sharpe Manufacturing Co., Chino Copper Co., Eric Forge Co., Jones & Laughlin Steel Co., Koppers Co., American Shell Co., Sherwin-Williams Co., Colorado Fuel & Iron Co., United States Steel Co.

Furthermore, if the facilities are discarded and subsequently brought back into use, that fact must be reported and the amortized amount is taxable income. On the other hand, facilities amortized for loss of use may be used until worn out without the deduction being subject to tax.

There are many cases where the value in use of facilities retained in use has been determined to be the same as the salvage value and value in use has been based upon salvage value. In all cases where this was done the taxpayer has received the same amortization allowance which he would have received had the facilities been discarded, but had the facilities been discarded he would be required to report the amortization allowed upon them as income if he subsequently uses them, while through this method he can use up such facilities and get the amortization tax free.

It is manifest that this method is grossly discriminatory against the taxpayer who honestly discards surplus facilities.

NO SOUND BASIS FOR AMORTIZATION FOR LOSS OF USE OF FACILITIES RETAINED IN USE

The whole method of measuring the capital value of facilities for the purpose of determining whether there is an amortizable capital loss by applying a ratio of use to capacity for use is fundamentally unsound, and any result obtained by such method is necessarily inaccurate.

This method of measuring capital losses by comparing the production of the three years 1921, 1922, and 1923 with the capacity for production, whether the production of the entire plant or whether the production of the particular facility installed during the war is used to measure value in use, is based upon the obviously fallacious theory that manufacturing equipment is not worth to the owner what it will cost to replace it, unless it is used to full capacity all of the time. No manufacturing plant is operated to full capacity every day in the year for every year of its useful life. If any such standard were applied to determine the value of the plant assets of manufacturers for the purpose of determining solvency, there are few of our most successful concerns which could not be shown to be insolvent. It is obvious that Congress did not intend that capital values which could be legitimately included in the security offered for postwar loans or stock issues should be considered capital losses for income tax purposes, yet that is just what is done by this method of determining amortization.

In measuring value by use, some standard of use must be assumed to represent full value, whether full value be cost or cost of replacement.

As has been shown, the value of a facility depends not only upon its present use but also upon its availability for future use. Any formula for determining value which fails to consider availability for future use, to meet peak demands, to replace other facilities, or to meet expansion in the business necessarily gives a value below the actual value, and shows a loss where no loss exists.

Even if a formula could be devised which would give due consideration to availability for future use, 100 per cent use can not be assumed to be required to represent 100 per cent value.

The value of a facility in any business depends upon whether its use may be expected to return its value and a profit during its useful life. As a facility may be a profitable investment, even though used to but a fraction of its capacity or unprofitable when used to full capacity, it is an economic impossibility to measure value in terms of use as the regulations require. There is of course a relationship between use and profit, as there is a relationship between size and weight, but value can be no more measured by use than distance can be measured by the pound or weight by the yard.

Whether a present excess of capacity, represented in whole or in part by facilities acquired during the war, will be needed to earn the high profits of periods of peak demand, to replace older facilities, or to meet the demand of a growing business is entirely a matter of business foresight and judgment. Except in the case of single oversized units, the taxpayer is at liberty to exercise his judgment. If, in his judgment, excess units can not be profitably employed, the regulations very properly permit him to discard them and amortize the difference between the cost and salvage value. In case the taxpayer returns such facilities to use he is required to report the fact, and the amortization previously deducted should be taxed as income. This privilege of discarding facilities has been freely exercised by taxpayers.

Having the privilege of discarding facilities which are not needed, it may be assumed that when a taxpayer fails to discard a facility he retains it in use, because, in his judgement, it will be to his advantage to do so. The judgement of the taxpayer, as to the opportunity to profitably employ surplus capacity in his business, as evidenced by his voluntary conduct in failing to discard, should be conclusive as to the necessity of such capacity for present or future use.

It is conceded that excess capacity may not produce as great a profit upon the investment as a minimum capacity, and that carrying facilities until the capacity represented by them is required, may result in loss of income. The income lost by carrying an unproductive investment until it becomes productive is not a legitimate deduction from taxable income, because, if such income had been realized, it would have been taxable.

This method of determining capital losses does not even confine the loss to the income not realized upon surplus capacity, but treats all capital invested in capacity, in excess of the average required for present use, as a total permanent capital loss.

It is possible that any investment in equipment, whether made during the war, or before or since the war, may turn out to be unprofitable, and that the full cost, plus a profit, may not be realized during the life of the equipment.

The war facilities which a taxpayer elects to retain in use can have no different status than any other facilities. As to all facilities he takes the risk incident to the business of recovering their value through annual deductions for depreciation. If a residual undepreciated value remains, when the use of such facilities are abandoned, the residue is taken as loss of useful value.

No deduction of a capital loss should be permitted until it can be computed with reasonable certainty. To attempt to say now that a taxpayer will not recover through operation the value of facilities he elects to retain in use, and to attempt to compute the resulting loss involves nothing more than sheer speculation

It is therefore our position that there is no legitimate basis for the amortization of anything, except the loss on discarded facilities, and the excess war cost of facilities retained in use, unless the facility retained in use is a single unit of excess size, in which case the amortization should be the difference between the cost and the post-war cost of reproduction of a facility of size adequate to meet the peak demands of the business, when reasonable future expansion is duly considered.

OTHER IMPORTANT FACTORS IGNORED

Even assuming that it were possible to measure value in terms of use, several vitally important factors have been ignored in all amortization determinations by the Income Tax Unit.

1921 ABNORMAL YEAR

The year 1921 was the worst year industrially that this country has seen since 1893. In 1922 industrial conditions improved. The years 1923, 1924, and 1925 have been prosperous, and industrial production has nearly reached the production of 1917, and in many instances is greater than in 1918. By using the average production of the years 1921, 1922, and 1923 as a basis of measuring value, the value of facilities which were used to their full capacity in 1923, 1924, and 1925 is so reduced as to represent capital losses.

In the following cases amortization was based upon the production of 1921 alone, or the average of 1921 and 1922 and 1923 was not even considered: Allan Wood Iron & Steel Co., Allegheny Steel Co., Atlas Crucible Steel Co., Camden Forge Co.

WAR PRODUCTION AS BASIS OF CAPACITY

The peak of production during the war period is generally assumed to be the capacity of facilities for the purpose of determining value in use. Where amortized facilities were not completed during the war period, capacity has usually been estimated or based upon rated capacity.

That war production is not a proper basis for the determination of normal peace-time usefulness was recognized by Solicitor Hartson in his opinion on the amortization allowance to the J. I. Case Threshing Machine Co.

In that case the value in use was determined on the basis of man-hours of labor employed. As man-hours of labor employed can be directly translated into production, there is no difference in principle between basing capacity on war man-hours employed and on production.

In his opinion the solicitor condemned this basis, for the reason that it is not necessary for a facility to be operated overtime, as it usually was during the war, to have 100 per cent value in time of peace. To meet a capacity fixed by war production, it would be necessary to operate facilities under war conditions, when two or three labor shifts a day were employed to keep facilities in continuous operation, when maintenance was deferred to avoid shutting down for repairs, and when there was a continuous demand for production equal to the maximum capacity.

In determining depreciation allowances the income tax unit has allowed excess depreciation based upon the extraordinary operation during the war period to the very taxpayers whose amortization allowances upon the same facilities are based upon the assumption that war production represents normal capacity. This was done in the case of the Bethlehem Steel Co. and in many other cases.

POSTWAR CAPITAL EXPENDITURES

The fact that since the ending of the war a manufacturer has increased the capacity created by his war expenditure by postwar expenditures for plant should be conclusive that he has 100 per cent need for the capacity created by war expenditures. A taxpayer who has added to his capacity since the war should certainly be stopped from claiming that he has suffered a deductible capital loss because of excess capacity created during the war.

It is also true that to the extent that facilities were added during the war period the necessity for replacing older similar facilities disappears, and a taxpayer who has made postwar expenditures to replace worn out, inadequate, or obsolete equipment should be estopped from claiming a loss of value in use on similar equipment installed or acquired during the war.

This factor has been entirely ignored by the income tax Unit in determining amortization due to loss of value in use. In investigating amortization claims no investigation of postwar capital expenditures has been made.

In the J. I. Case Threshing Machine Co. case, the solicitor says:

> It also appears in this case that the taxpayer constructed additions to its plant in 1919 and 1920 which were more extensive than its war-time additions. The business during these two postwar years exceeded the war business. In

determining the value in use of facilities or equipment, those acquired during the war years shall not be considered to have been reduced in value in terms of use where the taxpayer acquired in postwar years additional facilities and increased capacity of its plant, unless it can be satisfactorily shown that the facilities acquired during the war years were not of proper type or as capable of economic use in postwar times as the new facilities. In other words, when a taxpayer has and uses in postwar years not only the facilities acquired during the war but additional facilities subsequently acquired for the same uses and purposes and of substantially the same character as those acquired during the war years, it is prima facie evidence that any reduction of value in terms of use of the war facilities was caused by the overexpansion in postwar years and not as a result of facilities not being useful and needed to full, normal capacity for postwar business. In such cases it could not be said that the war-time facilities were reduced in value in terms of use. If a taxpayer has a warehouse which he erected during the war years, and postwar business demands required the erection of another warehouse of similar kind and capacity, and the one erected during the war times was not used to full capacity after the amortization period solely because of the subsequent erection of the other buildings, no reduction in value in terms of use is shown. Such a situation was not contemplated by the statute or the regulations made pursuant thereto. The fact that additions to plant and facilities of substantially the same kind, character, and use were made in postwar years to a greater extent than during the war years prima facie establishes the fact that the war facilities were just as valuable in terms of use for postwar business as during the war.

It was shown that the capital charges for plant expenditures by the United States Steel Co. since the close of the war exceeded the war expenditures, and that in many instances items held to be amortizable because of excess capacity were duplicated by purchases and additions since the war.

The Atlas Crucible Steel Co. was also allowed amortization based on useless surplus capacity, notwithstanding the fact that capacity was increased by postwar capital expenditures.

The postwar expenditures of the Firestone Tire Co. to increase a war capacity which the bureau determined to be 26 per cent in excess of peace-time requirements have been noted.

Because of the failure of the income tax unit to investigate or to require the taxpayers claiming amortization to furnish any information as to whether items claimed to be amortizable have been duplicated or replaced since the war, or as to whether war plant capacity claimed to be excessive has been increased by postwar expenditures, it is not possible to ascertain to what extent amortization has been allowed in cases where this has occured.

REQUIRED CAPACITY SHOULD NOT BE CONSIDERED TO BE LESS THAN PRE-WAR CAPACITY

It has been the policy of the Income Tax Unit to allow amortization for loss of useful value upon all plant expenditures made during the war period, regardless of whether such expenditures increased plant capacity or merely replaced facilities which had reached the end of their useful lives during the war and would have been replaced regardless of the war.

Assuming, but not conceding, that all war expenditures for the replacement of plant facilities were made to contribute to the prosecution of the war, it is also reasonable to assume that the plant facilities existing when we entered the war represented the taxpayer's judgment of the minimum required for normal commercial operation. To maintain pre-war capacity required the constant replacement of worn-out units, and while a taxpayer may be entitled to amortize the excess war cost of replacements, it is clear that a taxpayer can not claim that he has not full value in use of facilities which merely replace pre-war equipment.

In re the claim of William Silver & Co. (Inc.), Solicitor Hartson ruled, in unpublished Recommendation No. 3548, that this taxpayer could not even amortize the excess war cost of a building built to replace a pre-war building which burned down in 1918. On the other hand, Solicitor Gregg ruled in the United States Steel case that the fact that facilities acquired during the war were mere replacements of pre-war facilities did not affect the taxpayer's right to amortize them.

REDUCED VALUE IN USE BASED ON ESTIMATED PRODUCTION

Attention has already been called to the fact that in the United States Steel case the value in use was determined upon estimates of production for 1922 and 1923 which were so far below the actual production of those years that the substitution of the actual for the estimated production makes a difference of about 40 per cent in the amortization allowance.

In ordering the reconsideration of the United States Steel case the Commissioner of Internal Revenue ordered that actual production be used in place of the estimates. In his ruling in this case Solicitor Gregg held that value in use should be based upon actual instead of estimated production.

Allowing amortization for reduced value in use based upon estimated production has been the general practice of the income-tax unit. As the production of 1921 has to a large extent influenced these estimates, it is safe to assume that they are generally low and that the amortization allowed would be generally excessive, even if the method were sound. The redetermination of the United States Steel case does not affect the other cases, and unless those other cases are reconsidered excessive amortization allowances based upon estimated production will stand.

Estimated production for a portion of the postwar period has been used in the following cases involving allowances exceeding $500,000 in addition to the United States Steel case: Allis Chalmers Manufacturing Co., Aluminum Co. of America, American Rolling Mills Co., Bartlett Hayward Co., Colorado Fuel & Iron Co.

DISCRIMINATION WITH REFERENCE TO REDUCED COST OF REPLACEMENT

The lack of any uniform policy, the total lack of rulings or instructions, and the hopelessly incompetent supervision of amortization determinations has resulted in the grossest kind of discrimination among taxpayers with reference to the allowance of amortization due to reduced cost of replacement or facilities retained in use.

It is clear that capital losses have been sustained by all manufacturers who acquired facilities during the war at costs exceeding the postwar cost of replacing such facilities. These losses can be definitely determined and should be amortized in all cases in which they were sustained, regardless of the degree to which a facility is found to be in use.

The regulations are silent as to whether a taxpayer who is allowed amortization for lack of use is also entitled to amortize the loss due to reduced cost of replacement. Mr. De La Mater's manual, promulgated in 1922, provides that when the per cent of value in use is determined it shall be applied to the reduced cost of replacement to determine value in use. The value in use deducted from the war cost is the amortization allowed. Thus, if a facility which cost $100,000 during the war and is replaceable after the war for $80,000 is determined to be 80 per cent in use, the application of the 80 per cent to the reduced cost of replacement will give a value in use of $64,000 and amortization of $36,000, while the application of the 80 per cent to the war cost will give a value in use of $80,000 and amortization of $20,000.

This manual appears to have been generally ignored, although it has never been supplanted by any written statement from anybody in authority from the commissioner down to the section chief in charge of the engineers who determined amortization. Each individual engineer appears to have been permitted to follow his own whim as to whether a taxpayer should be allowed the loss due to reduced replacement cost in addition to the loss due to reduced value in use. Some engineers followed the consistent policy of allowing amortization upon both reduced value in use and reduced replacement cost. Some engineers allowed amortization for reduced value in use only when it exceeded the loss due to reduced replacement cost, and in such event applied the value in use percentage to the war cost. Other engineers appear to have flitted from one school of thought on this subject to the other. Thus the amortization determinations in the Aluminum Co. of America case and in the United States Steel case were made by the same engineer, but in the Steel case amortization was based on both loss of use and on reduced replacement cost, while in the Aluminum Co. case it was based upon loss of use only.

These allowances were presumed to be reviewed by a reviewing engineer. Mr. Stephen de La Mater was in charge of this work until the fall of 1923, when he resigned and was succeeded by Mr. J. T. Keenan. These chiefs of sections were supposed to enforce some uniformity of policy, but taxpayers' allowances for reduced replacement cost appear to have depended upon their luck as to what engineer handled the case rather than upon the merits of their claim, notwithstanding the existence of reviewers, a chief of a section, and a head of the engineering division.

With the exception of the J. I. Case Threshing Machine Co. case, in which this question was not raised, the questions involved in the allowance of nearly $600,000,000 of deductions for amortization appear to have never been called to the attention of or to have received any consideration by the commissioner, the deputy commissioner, the solicitor, or any other higher official of the Bureau of Internal Revenue until those questions were brought to their attention by this investigation. Nobody ever paid any attention to the ruling of the solicitor in the J. I. Case Threshing Machine Co. case. We do not know whether all claimants were satisfied with the allowances made, or whether rulings on appeals were not published, but the fact is that until the ruling of Solicitor Gregg in the Steel case, published on October 26, 1925, there was not a printed word on this particular question which was involved in every amortization case.

In his ruling in the United States Steel case, Solicitor Gregg holds that where the value in use of a particular facility is determined independently of other facilities the loss due to reduced cost of replacement shall be allowed, in addition to amortization for reduced usefulness, but that where the usefulness of a facility is based upon the average usefulness of all similar facilities the loss due to reduced cost of replacement should not be allowed.

Thus the taxpayer's right to amortize losses due to reduced cost of replacement is not to depend upon whether such losses have been sustained, but upon the engineer's whim as to whether he will use the general or the special method of determining an entirely different matter—the loss of usefulness. The only possible justification for this absurd ruling is the fact that the disallowance of a loss which clearly should be allowed will result in reducing the illegitimate allowances based upon loss of use. The gross discrimination which has heretofore prevailed will not be reduced by this ruling.

The discrimination which has resulted from this failure to adhere to any definite policy is well illustrated by a comparison of the Berwind-White Coal Mining Co. and the McKeesport Tin Plate Co. cases.

As has been shown, two different bases were used in determining the value in use in these cases. In the McKeesport case the value in use was determined on the basis of the postwar use of the specific facility, which resulted in a loss of usefulness of about half of what would have been shown had the method used in the Berwind-White case been followed. To carry the discrimination further, the Berwind-White Coal Mining Co. was allowed to also amortize the loss due to reduced postwar replacement cost, while the McKeesport Tin Plate Co. denied amortization on this ground.

Thus amortization for reduced postwar replacement cost was specifically denied under conditions under which Mr. Gregg's ruling declares it should have been allowed, and was specifically allowed where Mr. Gregg's ruling says it should have been disallowed.

These two cases show three distanct forms of discrimination.

1. The Berwind-White company was permitted to include its scrapped power plant in capacity for the purpose of determining whether there was a postwar surplus of capacity. The McKeesport Tin Plate Co. was not permitted to do this.

The Berwind-White company was permitted to spread amortization on commitments instead of payments. The McKeesport Tin Plate Co. was denied the right to do this.

3. The Berwind-White company was permitted to amortize both reduced useful value and reduced replacement cost, while amortization based on reduced replacement cost was denied the McKeesport company.

The following is a partial list of the larger cases in which amortization for both reduced value in use and for reduced cost of postwar replacement has been allowed under conditions condemned by Solicitor Gregg's ruling: Bethlehem Steel Co. and subsidiaries, United States Steel Co. and subsidiaries, International Harvester Co., Interstate Iron & Steel Co., Le Blond Machine Tool Co., Moline Plow Co., Norton Co., Porctor and Gamble, Air Reduction Co., Atlantic Refining Co..

Summary of amortization allowances of $500,000 or over, as allowed by appraisal section up to April 30, 1925

[*S. E. P., Sound engineering principles. **"Solicitor's ruling," Ruling of Solicitor Hartson, published November, 1924, in the J. I. Case Threshing Machine Co. case]

Name of taxpayer	Classification of business	Original amount claimed	Final amount claimed	Amount finally allowed	Amortization allowed on property discarded or sold	Amortization allowed on reduced replacement cost
Air Reduction Co.	Miscellaneous	$541,839.96	$1,126,658.95	$887,098.95		$533,623.18
Alabama Dry Dock & Shipbuilding Co.	Shipbuilding		540,616.67	508,943.41	$439,543.28	
Allan Wood Iron & Steel Co.	Iron and steel	566,185.50	2,817,232.05	2,091,893.63	30,995.11	
Allegheny Steel Co.	do	201,375.94	718,701.10	519,970.57	242,323.80	
Allis-Chalmers Manufacturing Co.	Manufacturers of machinery	598,908.61	1,573,171.59	1,001,438.71	141,641.09	
Aluminum Co. of America	Aluminum manufacturers	6,852,697.36	18,268,435.82	15,589,614.39		
American Clay Machinery Co.	Munitions	670,953.85	1,565,936.14	1,365,335.65	1,054,373.63	
American Locomotive Co.	Machinery manufacturers	816,488.86	2,834,896.14	1,714,403.18	484,706.81	160,670.61
American Manufacturing Co.	Miscellaneous	521,191.58	1,448,734.54	751,092.77	688,202.43	62,890.34
American Rolling Mills Co.	Iron and steel	201,751.13	2,597,982.94	1,537,318.18	67,108.14	
American Shell Co.	Munitions	1,202,287.67	864,721.77	864,721.77	657,623.59	
American Shipbuilding Co.	Shipbuilding	8,004,114.60	8,737,047.58	3,567,509.60	2,659,339.92	
Ames Shipbuilding & Dry Dock Co.	do	1,703,728.07	1,474,778.65	1,018,642.72	1,018,642.72	
Anaconda Copper Mining Co.	Mining	538,949.26	6,207,932.31	2,744,410.77		
Acheson Graphite Co.	Miscellaneous	394,480.46	699,065.89	577,282.88	577,282.88	
Atlantic Coast Co.	Shipping	2,182,674.65	2,182,674.65	1,136,330.80		1,136,330.86
Atlantic & Pacific Steamship Co.	do	1,206,487.36	1,206,487.36	1,029,223.36		1,029,223.36
Atlas Crucible Steel Co.	Iron and steel	251,808.20	778,440.74	710,793.23	119,634.84	
Atlas Powder Co. and subsidiary (Richards & Co.)	Munitions	1,748,080.30	1,954,275.45	1,882,054.67	1,022,138.07	
Atlantic Refining Co.	Oil	2,826,547.23	6,542,743.50	3,165,001.67		2,992,853.76
Babcock & Wilcox	Machinery manufacturers	4,274,215.89	4,274,215.89	2,145,625.28	96,553.14	
Baldwin Locomotive Works	do	Not stated.	4,070,630.53	2,990,806.64		
Baltimore Dry Dock & Shipbuilding Co.	Shipbuilding	Not stated.	3,812,306.36	3,384,965.86	3,384,965.86	
Bartlett Haywood Co	Machinery manufacturers	1,508,819.03	1,459,368.34	1,442,056.43	*697,515.27	
Bauer & Black	Miscellaneous	178,822.57	537,726.07	537,726.07	372,531.73	
Bausch & Lomb Optical Co	Scientific instruments	2,495,094.31	2,682,539.41	2,377,789.21	1,092,588.46	
Bethlehem Steel Co	Iron and steel		48,008,536.72	22,103,942.43	9,822,588.58	10,045,243.99
Bliss, E. W., Co	Machinery manufacturers	1,731,746.97	1,730,746.97	1,243,571.09	96,930.66	
Brier Hill Steel Co	Iron and steel	3,498,676.88	9,293,733.23	6,217,973.95	6,217,973.95	
Brill, J. G., Co	Machinery manufacturers	Not stated.	900,788.54	603,182.63	132,631.75	
Brown & Sharpe Manufacturing Co.	Machine tools	1,119,357.32	949,856.82	541,325.62		
Buda Co.	Machinery manufacturers	280,721.77	955,554.50	668,765.27		
Camden Forge Co.	Iron and steel	816,536.09	1,454,334.74	1,336,829.27	1,268,507.95	
Carbon Steel Co.	do	Not stated.	1,854,089.74	1,191,596.24	1,191,596.24	
Carib Steamship Co.	Shipping	669,211.05	669,211.05	669,211.05	669,211.05	
Central Steel Co.	Iron and steel	419,284.00	2,121,675.23	1,571,391.35	172,171.40	
Chile Copper Co.	Mining	4,313,223.24	4,313,223.24	2,844,603.07		2,844,503.07
China Mail Steamship Co. (Ltd.)	Shipping	Not stated.	1,530,502.50	1,312,861.25		1,312,861.25
Chino Copper Co.	Mining	282,165.64	1,628,702.34	1,107,086.14	433,416.82	

Cleveland Cliffs Iron Co.	do	900, 180. 41	4, 156, 210. 27	1, 860, 791. 06	506, 582. 80	303, 623. 21
Colorado Fuel & Iron Co.	Iron and steel	4, 653, 560. 21	4, 653, 560. 21	2, 979, 432. 75		
Colts Patent Fire Arms Co.	Munitions	2, 871, 036. 92	6, 734, 144. 25	3, 060, 109. 96	2, 405, 406. 01	
Columbia River Shipbuilding Corporation.	Shipbuilding	1, 101, 717. 99	1, 101, 717. 99	938, 692. 92	938, 692. 92	
Crucible Steel Co.	Iron and Steel	659, 000. 00	10, 924, 025. 52	8, 912, 879. 00		
Cuban-American Sugar Co	Foodstuffs	Not stated.	2, 742, 612. 86	1, 675, 703. 39		
Cudahy Packing Co	Food products	215, 705. 99	504, 626. 71	500, 360. 13	113, 701. 29	
Diamond Alkali Co.	Chemicals	586, 537. 71	1, 756, 453. 64	1, 344, 465. 15		
Dollar Steamship Co.	Shipping	536, 999. 69	721, 958. 44	713, 080. 38		713, 080. 38
Doullut & Williams Shipbuilding Co. (Inc.)	Shipbuilding	No. stated.	1, 371, 747. 67	1, 241, 720. 53	1, 241, 720. 53	
Downey Shipbuilding Co.	do	1, 425, 948. 90	1, 425, 948. 90	1, 270, 991. 78	357, 967. 91	
E. I. Du Pont De Nemours & Co.	Mu itions	Not det.	17, 246, 224. 45	15, 369, 123. 55	15, 204, 780. 49	
J. F. Duthie & Co.	Shipbuilding	1, 142, 615. 61	1, 142, 615. 61	707, 972. 78	707, 972. 78	
Edgewater Steel Co.	Iron and steel	443, 304. 71	951, 848. 98	700, 817. 37	36, 525. 35	435, 759. 42
Eddystone Munitions Co.	Munitions	1, 757, 350. 21	1, 595, 179. 37	1, 595, 179. 37	1, 595, 179. 37	
Erie Forge Co.	Iron and steel	1, 265, 306. 08	1, 265, 306. 08	1, 132, 354. 33	360, 140. 13	
Evans Engineering Corporation	Munitions	812, 863. 73	812, 863. 73	512, 401. 85	512, 401. 85	
Federal Shipbuilding Co.	Shipbuilding	6, 887, 854. 14	12, 084, 402. 34	10, 849, 786. 04	1, 958, 379. 78	(1)
W. & A. Fletcher Co.	do	1, 456, 245. 56	1, 456, 245. 56	529, 574. 63		
Ford Motor Co.	Auto manufacturers	4, 464, 277. 67	1, 863, 845. 88	1, 069, 072. 11	371, 264. 65	297, 640. 82
Firestone Tire Co.	Tires and rubber		3, 950, 679. 61	2, 016, 194. 30	551, 210. 57	
General Chemical Co.	Chemicals	1, 815, 598. 60	4, 092, 895. 45	3, 110, 102. 92	1, 713, 926. 01	
General Electric Co.	Machinery manufacturers	9, 075, 180. 89	6, 508, 432. 85	3, 249, 367. 49	1, 391, 706. 58	670, 304. 39
Globe Shipbuilding Co.	Shipbuilding	125, 945. 05	800, 705. 50	646, 850. 43	567, 238. 89	
Gorham Manufacturing Co.	Munitions	521, 700. 60	614, 498. 40	594, 636. 72	505, 018. 31	
Grace, W. R. & Co.	Shipping	437, 715. 00	3, 860, 539. 68	2, 158, 500. 60		1, 886, 140. 02
Great Lakes Engineering Co.	Shipbuilding	Not stated.	2, 142, 277. 21	1, 700, 712. 16	1, 700, 712. 16	
The Hamilton Furnace Co.	Iron and steel	1, 128, 181. 16	1, 128, 181. 16	769, 964. 65		
Hanlon Dry Dock and S. Co.	Shipbuilding	408, 833. 41	961, 382. 20	914, 934. 39	885, 999. 10	
Heppenstall Forge & Knife Co.	Machinery Manufacturers	679, 220. 68	955, 678. 23	899, 387. 44	279, 808. 53	
Hydraulic Press Steel Co.	Iron and steel		3, 382, 924. 83	1, 854, 650. 05	1, 461, 894. 65	
Ingersoll Rand Co.	Machinery Manufacturers	254, 494. 50	2, 324, 323. 44	829, 320. 33	260, 192. 25	
International Harvester Co.	do	1, 567, 811. 42	4, 300, 597. 99	3, 716, 284. 20		1, 586, 068. 92
Interstate Iron & Steel Co.	Iron and Steel	110, 977. 42	610, 919. 93	534, 878. 44	50, 643. 11	181, 017. 62
Jones & Laughlin Steel Co.	do	10, 902, 580. 84	16, 479, 478. 12	7, 253, 499. 17	1, 501, 332. 84	4, 408. 32
Kerr Navigation Co.	Shipping	Not stated.	5, 498, 063. 12	4, 390, 115. 49	4, 390, 115. 49	
The Koppers Co.	Iron and steel	4, 104, 338. 34	4, 104, 338. 34	2, 505, 923. 16	251, 790. 00	
La Belle Iron Works	do	600, 000. 00	2, 517, 143. 76	1, 088, 092. 52	77, 947. 53	
Lackawanna Steel Co.	do	6, 202, 014. 77	5, 207, 810. 04	3, 400, 579. 66	3, 400, 579. 66	
Le Bond Machine Tool Co.	Machine tools	413, 858. 45	678, 603. 51	629, 514. 75	47, 789. 27	39, 605. 54
Lincoln Motor Co.	Auto Manufacturers	4, 819, 645. 81	4, 819, 645. 81	6, 048, 915. 69	6, 048, 915. 69	
Long Beach Shipbuilding Co.	Shipbuilding	1, 526, 958. 57	1, 526, 958. 57	1, 465, 334. 87	1, 465, 334. 87	
Los Angeles Shipbuilding & Dry Dock Co.	do	1, 203, 718. 50	4, 646, 268. 54	2, 915, 922. 70	2, 915, 922. 70	
Luckenbach Steamship Co. (Inc.)	Shipping	613, 026. 44	4, 194, 627. 16	2, 017, 060. 62		2, 017, 060. 62
Lukens Steel Co.	Iron and steel	1, 012, 425. 35	3, 385, 273. 37	2, 418, 142. 54		
McDougal-Duluth Co.	Shipbuilding	Not stated.	2, 875, 920. 50	2, 763, 880. 44	2, 763, 880. 44	
McKeesport Tin Plate Co.	Iron and steel	811, 121. 12	1, 134, 865. 33	691, 423. 71		
Mckinney Steel Co.	do	1, 102, 858. 78	1, 200, 286. 08	1, 185, 859. 15	14, 427. 93	
Manitowoc Shipbuilding Co.	Shipbuilding	1, 289, 896. 74	1, 023, 695. 99	1, 014, 558. 99	1, 014, 558. 99	
Mattiessen & Hegler	Miscellaneous	287, 081. 48	969, 159. 73	832, 355. 37	687, 682. 10	47, 823. 61
Merchants Shipbuilding Co.	Shipbuilding	Not stated.	4, 493, 535. 49	1, 422, 770. 58	1, 422, 770. 58	
Mesta Machine Co.	Machinery Manufacturers		1, 296, 930. 30	854, 845. 86	230, 539. 00	
Midvale Steel & Ordnance Co.	Iron and steel	5, 018, 661. 00	10, 289, 558. 18	9, 230, 440. 16	9, 330, 440. 16	

Summary of amortization allowances of $500,000 or over, as allowed by appraisal section up to April 30, 1925—Continued

Name of taxpayer	Classification of business	Original amount claimed	Final amount claimed	Amount finally allowed	Amortization allowed on property discarded or sold	Amortization allowed on reduced replacement cost
Moline Plow Co.	Machinery manufacturers	$157,466.42	$934,905.42	$928,816.56	$56,804.31	$493,336.01
Moore Shipbuilding Co.	Shipbuilding	407,710.86	7,726,243.15	4,412,653.94	2,104,112.54	
Morgan Engr. & Canton Co. (steel foundry)	Machinery manufacturers	43,888.85	1,118,109.12	720,525.13	97,263.05	
Morse Dry Dock & Repair Co.	Shipbuilding	2,253,327.64	2,675,259.20	1,684,024.06	532,607.23	
Munson Steamship Line	Shipping	546,965.90	1,072,130.84	927,668.06		927,668.08
National Acme Co.	Machine tools	310,279.02	1,289,231.05	1,003,751.91	102,000.00	
National Aniline Chemical Co.	Chemicals and dyes	550,567.38	10,788,867.06	9,912,740.08	8,258,989.43	1,653,750.65
National Malleable Casting Co.	Iron and steel		1,111,764.59	988,235.19		
Newport Mining Co.	Mining	1,211,000.09	3,452,013.41	1,185,270.33	521,517.69	
New York Air Brake Co.	Machinery manufacturers	722,077.34	1,705,115.01	1,462,237.64	1,065,083.90	
New York Shipbuilding Corporation	Shipbuilding	1,885,436.83	4,262,336.69	3,584,295.80	1,968,539.39	
Nicholson File Co.	Machine tools		678,281.26	678,281.26		
Niles Bement Pont Co.	do.		1,388,833.84	1,113,465.38		
Northwest Steel Co.	Shipbuilding	815,762.46	815,762.46	615,762.46	615,762.46	
Norton Co.	Abrasives		1,296,133.69	1,002,977.30	35,590.51	190,182.65
Ohmer Fare Register Co.	Munitions	831,747.90	597,942.68	539,313.83	530,708.90	
Ore Steamship Corporation	Shipping	Not stated.	1,534,952.74	1,466,389.53		
Oriental Navigation Co.	do.	349,286.25	827,443.77	710,883.00	710,883.00	
Pacific Coast Shipbuilding Co.	Shipbuilders	1,299,884.34	2,233,879.53	1,097,950.50	561,988.07	
Pacific Coast Steel Co.	Iron and steel	1,153,351.81	1,153,351.81	1,015,275.24	604,526.82	
Pacific Steamship Co.	Shipping	440,000.00	1,423,917.12	645,264.07		
Pan American Petroleum Transporattion Co.	do.	5,663,360.21	5,663,360.21	1,892,624.98		1,892,624.98
Pierce Oil Corporation	Oil	2,000,000.00	3,922,719.19	1,393,368.21	848,625.83	482,275.51
Pittsburgh Steel Products	Iron and steel	1,985,422.08	4,671,276.48	2,696,858.86	142,577.91	19,113.52
Pocohontas Fuel Co.	Mining	1,270,248.86	1,539,763.33	854,218.02		246,922.70
Potters & Johnson Machine Co.	Machine tools	492,527.27	502,156.33	502,156.33	410,725.66	
The Pressed Steel Car Co.	Machine manufacturers	460,911.70	1,175,453.88	572,167.06	268,020.88	
Procter & Gamble	Soap		5,333,254.49	3,997,848.67	666,912.00	1,017,433.00
Pure Oil Co.	Oil	809,792.50	809,792.50	788,559.59		788,559.59
Pusey & Jones Co.	Shipbuilding	6,732,796.67	6,530,173.15	4,007,964.81	3,832,528.72	175,436.09
Quaker Oats Co.	Food products	1,285,463.73	4,145,518.13	2,583,048.30		
Ray Consolidated Copper Co.	Mining	259,219.07	1,283,341.78	919,310.77	158,604.34	390,472.49
Republic Iron & Steel Co.	Iron and steel	5,453,302.49	5,148,798.61	3,341,998.73	174,918.51	
Reoblings Sons Co.	do.	1,435,611.09	1,435,611.09	1,182,725.80		
Seattle Northern Pacific Shipbuilding Corporation	Shipbuilding	1,828,664.65	1,828,664.65	1,828,664.65	1,828,664.65	
Sharon Steel Hoop Co.	Iron and steel	3,630,932.24	3,629,154.55	736,999.72	29,313.65	697,973.85
Sherwin-Williams Co.	Chemicals and dyes	802,081.85	802,081.85	591,244.37	218,645.05	
Sinclair Oil & Refining Co.	Oil	2,014,403.74	3,752,869.71	2,236,512.20	750,331.16	1,486,181.04
Skinner & Eddy Corporation	Shipbuilding	4,752,108.62	4,752,108.62	4,442,978.09	4,442,978.09	
Solvay Process Co.	Miscellaneous	1,797,414.00	2,551,495.87	909,869.24	135,075.47	
South Porto Rico Sugar Co.	Foodstuffs	495,224.27	1,521,684.46	1,009,170.57		1,009,170.57

Southwestern Shipbuilding Co.	Shipbuilding	195, 840. 71	2, 004, 215. 40	1, 563, 262. 02		
Sperry Flour Co.	Foodstuffs	447, 997. 84	2, 757, 636. 80	1, 027, 023. 81		
Standard Oil Co. of Indiana	Oil	3, 952, 000. 00	2, 887, 867. 43	2, 876, 318. 24	1, 418, 020. 49	1, 380, 385. 91
Standard Shipbuilding Corporation	Shipbuilding	1, 015, 788. 79	2, 365, 117. 13	2, 365, 117. 13	2, 365, 117. 13	
Standard Steel Works	Iron and steel	430, 060. 95	745, 641. 53	574, 213. 29		
The Stanley Works	Machine tools	790, 440. 10	790, 440. 10	715, 305. 01	556, 362. 65	
Steel & Tube Co. of America	Iron and steel	2, 114, 151. 37	5, 889, 013. 06	5, 232, 176. 46	5, 232, 176. 46	
Sun Oil Co. and allied companies	Oil	3, 230, 412. 59	10, 332, 259. 87	2, 756, 694. 86	1, 352. 40	2, 755, 342. 46
Swift & Co. (Libby, McNeil & Libby)	Foodstuffs	894, 083. 23	894, 083. 23	555, 334. 45		
Swift & Co.	do		1, 464, 006. 41	809, 353. 65	405, 334. 61	
Symington Machine Corporation	Munitions	698, 578. 25	696, 578. 25	696, 578. 25	696, 578. 25	
Standard Steel Car Co.	Machinery manufacturers		3, 071, 451. 14	3, 039, 763. 34	142, 959. 10	
Saginaw Shipbuilding Co.	Shipbuilding	1, 239, 757. 72	1, 239, 757. 72	1, 234, 763. 13	1, 234, 763. 13	
Standifer, G. M., Construction Co.	do	2, 939, 918. 79	2, 990, 397. 46	2, 665, 215. 13	2, 665, 215. 13	
Terry Shipbuilding Co.	do		1, 417, 939. 89	1, 340, 531. 49	1, 340, 531. 49	
Timken Roller Bearing Co.	Machine tools	984, 568. 52	832, 414. 93	772, 813. 89	73, 568. 96	
Todd Shipyards	Shipbuilding	2, 014, 081. 33	3, 609, 625. 82	2, 943, 103. 46	81, 790. 87	
Toledo Shipbuilding Co.	do	669, 525. 92	669, 525. 92	863, 192. 62		
Union Carbide & Carbon Corporation	Carbon and carbide	3, 628, 598. 67	8, 947, 339. 74	6, 561, 752. 09	244, 796. 08	
Union Construction Co.	Shipbuilding	861, 900. 00	1, 844, 980. 44	1, 411, 561. 26	1, 411, 561. 26	
Union Shipbuilding Co.	do	1, 581, 731. 28	1, 581, 731. 28	1, 333, 163. 96	691, 493. 15	
United Verde Extension Mining Co.	Mining	4, 127, 142. 40	4, 072, 303. 08	3, 322, 648. 92		
U. S. Steel Co.	Iron and Steel	83, 065, 169. 21	83, 411, 952. 51	55, 063, 312. 60	9, 783, 244. 02	16, 608, 264. 87
Utah Copper Co.	Mining	4, 855, 691. 69	5, 232, 820. 69	2, 783, 636. 89		13, 490. 36
Vacuum Oil Co.	Oil	1, 798, 360. 24	3, 473, 779. 60	2, 267, 928. 69	244, 578. 49	1, 650, 239. 29
Weirton Steel Co.	Iron and steel		2, 974, 033. 76	1, 988, 553. 50		1, 372, 426. 74
Western Pipe & Steel Co.	Shipbuilding	1, 433, 399. 34	1, 474, 599. 71	1, 440, 174. 61	1, 440, 174. 61	
Westinghouse Air Brake Co.	Machinery manufacturers	702, 820. 81	2, 403, 968. 71	1, 471, 369. 24	83, 569. 27	
Westmoreland Coal Co.	Mining	422, 526. 00	787, 254. 62	508, 093. 12	508, 093. 12	
Wheeling Steel & Iron Co.	Iron and steel	813, 475. 36	1, 136, 184. 09	718, 406. 16		
Whittaker Glessner Co.	do	3, 268, 709. 65	3, 268, 709. 65	2, 171, 888. 65	10, 054. 99	
Winnett Operating Co.	Shipping	705, 886. 54	705, 886. 54	576, 835. 27	576, 835. 27	
Worthington Pump & Machinery Corp.	Machinery manufacturers		2, 127, 929. 64	1, 900, 293. 78	176, 233. 93	
Youngstown Steel & Tube Co.	Iron and steel	3, 942, 848. 82	9, 965, 145. 57	6, 611, 647. 86	3, 204, 511. 88	
The Texas Co.	Oil	2, 727, 561. 95	2, 727, 561. 93	2, 431, 720. 43	271, 298. 23	2, 160, 422. 20
Total		331, 527, 046. 18	635, 934, 923. 16	425, 921, 945. 92	172, 625, 445. 74	65, 712, 505. 79

Summary of amortization allowances of $500,000 or over, as allowed by appraisal section up to April 30, 1925

[*S. E. P., Sound engineering principles. **"Solicitor's ruling," Ruling of Solicitor Hartson, published November, 1924, in the J. I. Case Threshing Machine Co. case]

Name of taxpayer	Amortization allowed on lowered value in use	Amount based on solicitor's ruling and on S. E. P.	Amount not based on solicitor's ruling	Amount not based on S. E. P. and not specifically condemned by solicitor's ruling	Closed under 1312	Outlawed	Inactive	Open
Air Reduction Co.	$353,475.16	$533,623.18		$353,475.46		$887,098.65		
Alabama Dry Dock & Shipbuilding Co.	69,400.13	439,543.28		69,400.13		508,943.41		
Allan Wood Iron & Steel Co	2,060,898.52	30,995.11		2,060,898.52		2,091,893.63		
Allegheny Steel Co.	277,646.77	242,323.80		277,646.77	$519,970.57			
Allis-Chalmers Manufacturing Co.	859,797.62	141,641.09		859,797.62				$1,001,438.71
Aluminum Co. of America	15,589,614.39	9,151,076.23		6,438,538.16				15,589,614.39
American Clay Machinery Co.	310,962.02	1,054,373.63	$310,962.02					1,365,335.65
American Locomotive Co.	1,069,022.76	645,300.42	1,069,022.75					1,714,403.18
American Manufacturing Co.		751,092.77						751,092.77
American Rolling Mills Co.	1,470,210.09	67,108.14	1,470,210.04					1,537,318.18
American Shell Co.	207,098.18	657,623.59		207,098.18	864,721.77			
American Shipbuilding Co.	908,169.68	3,567,509.60				3,567,509.60		
Ames Shipbuilding & Dry Dock Co.		1,018,642.72					$1,018,642.72	
Anaconda Copper Mining Co.	2,744,410.77		2,744,410.77					2,744,410.77
Acheson Graphite Co.		577,202.88				577,202.88		
Atlantic Coast Co.		992,360.95		143,969.85		1,136,330.80		
Atlantic & Pacific Steamship Co.				1,029,223.36		1,029,223.36		
Atlas Crucible Steel Co.	591,158.39	119,634.84		591,158.39	710,793.23			
Atlas Powder Co. and subsidiary (Richards & Co.)	859,916.60	1,022,138.07	859,916.60					1,882,054.67
Atlantic Refining Co.	172,147.91	319,741.10		2,845,260.57				3,165,001.67
Babcock & Wilcox	2,049,072.14	96,553.14	2,049,072.14			2,145,625.28		
Baldwin Locomotive Works	2,990,806.64		2,990,806.64					2,990,806.64
Baltimore Dry Dock & Shipbuilding Co.		3,384,965.86						3,384,965.86
Bartlett Haywood Co.	744,541.16	697,515.27		744,541.16		1,442,056.43		
Bauer & Black	165,394.34	122,869.47		414,856.60		537,726.07		
Bausch & Lomb Optical Co.	1,285,200.75	1,423,789.08		954,000.13				2,377,789.21
Bethlehem Steel Co.	2,236,109.86	14,845,210.57		7,258,731.86			22,103,942.43	
Bliss, E. W., Co.	1,146,640.40	336,132.34	558,149.88	349,288.87	1,243,571.09			
Brier Hill Steel Co.		6,217,973.95				6,217,973.95		
Brill, J. G., Co	470,550.88	132,631.75	470,550.88			603,182.63		
Brown & Sharpe Manufacturing Co.	541,325.62		541,325.62					541,325.62
Buda Co.	668,765.27		668,765.27					668,765.27
Camden Forge Co.	68,321.32	1,268,507.95		68,321.32		1,336,829.27		
Carbon Steel Co.		1,191,896.24						1,191,896.24
Carib Steamship Co.		664,211.05				664,211.05		

Central Steel Co.	1,399,219.95	172,171.40	1,399,219.95			1,571,391.35		
Chile Copper Co.		2,844,603.07						2,844,603.07
China Mail Steamship Co. (Ltd.)		1,312,861.25				1,312,861.25		
Chino Copper Co.	673,669.32	433,416.82	673,669.32			1,107,086.14		
Cleveland Cliffs Iron Co.	1,050,585.05	810,206.01		1,050,585.05				1,860,791.06
Colorado Fuel & Iron Co.	2,959,432.75	365,323.75	2,594,109.00				2,959,432.75	
Colts Patent Fire Arms Co.	654,703.95	2,405,406.01	654,703.95				3,060,109.96	
Columbia River Shipbuilding Corporation		938,692.92				938,692.92		
Crucible Steel Co.	8,912,879.00		8,912,879.00		8,912,879.00			
Cuban-American Sugar Co.	1,675,703.39			1,675,703.39				1,675,703.39
Cudahy Packing Co	386,658.84	113,701.29	386,658.84			500,360.13		
Diamond Alkali Co.	1,344,465.15		1,344,465.15					1,344,465.15
Dollar Steamship Co		713,080.38				713,080.38		
Doullut & Williams Shipbuilding Co. (Inc.)		1,241,720.53					1,241,720.53	
Downey Shipbuilding Co.	913,024.17	1,270,901.78						1,270,991.78
E. I. Du Pont De Nemours & Co.	164,343.06	15,204,780.49	164,343.06					15,369,123.55
J. F. Duthie & Co.		707,972.78			707,972.78			
Edgewater Steel Co.	228,532.60	472,284.77		228,532.60		700,817.37		
Eddystone Munitions Co.		1,595,179.37				1,595,179.37		
Erie Forge Co.	772,214.20	360,140.13		772,214.20		1,132,354.33		
Evans Engineering Corporation		512,401.85			512,401.85			
Federal Shipbuilding Co.	8,891,406.26	3,374,272.13	7,475,513.91			10,849,796.04		
W. & A. Fletcher Co.	529,574.63		529,574.63			529,574.63		
Ford Motor Co.	420,166.64	668,905.47		420,166.44		1,089,072.11		
Firestone Tire Co.	1,464,983.73	551,210.57	1,464,983.73		2,016,194.30			
General Chemical Co.	1,396,176.91	1,713,926.01		1,396,176.91				3,110,102.92
General Electric Co.	1,187,360.52	2,062,006.97	1,187,360.52					3,249,367.49
Globe Shipbuilding Co	79,611.54	646,850.43				646,850.43		
Gorham Manufacturing Co.	89,618.41	594,636.72						594,636.72
Grace, W. R. & Co.	272,360.58	1,374,816.44		783,684.16				2,158,500.60
Great Lakes Engineering Co.		1,700,712.16				1,700,712.16		
The Hamilton Furnace Co	769,904.65		769,904.65					769,904.65
Hanlon Dry Dock and S. C. Co	28,935.29	885,999.10		28,935.29				914,934.39
Heppenstall Forge & Knife Co.	619,578.91	279,808.53	619,578.91					899,387.44
Hydraulic Press Steel Co.	392,755.40	1,461,894.65		392,755.40				1,854,650.06
Ingersoll Rand Co.	569,128.08	260,192.25	569,128.08					829,320.33
International Harvester Co.	2,130,215.28	1,586,068.92	2,130,215.28		3,716,284.20			
Interstate Iron & Steel Co.	303,217.71	231,660.73	303,217.71			534,878.44		
Jones & Laughlin Steel Co.	5,752,758.01	1,505,741.16	5,752,758.01					7,258,499.17
Kerr Navigation Co.		4,390,115.49				4,390,115.49		
The Koppers Co.	2,254,133.16	251,790.00	2,254,133.16					2,503,923.16
La Belle Iron Works	1,010,144.69	77,947.83	1,010,144.69					1,088,092.52
Lackawanna Steel Co.		3,400,579.66						3,400,579.66
Le Bend Machine Tool Co.	542,119.94	87,394.81	542,119.94		629,514.75			
Lincoln Motor Co.		4,819,645.81		1,229,269.88		6,048,915.69		
Long Beach Shipbuilding Co.		1,465,334.87						1,465,334.87
Los Angeles Shipbuilding & Dry Dock Co.		2,604,435.64		311,487.06		2,915,922.70		
Luckenbach Steamship Co. (Inc.)		1,518,060.62		499,000.00				2,017,060.62
Lukens Steel Co.	2,418,142.54		2,418,142.54					2,418,142.54
McDougal-Duluth Co.		2,763,880.44						2,763,880.44
McKeesport Tin Plate Co.	691,423.71		691,423.71					691,423.71
Mckinney Steel Co.	1,171,431.22	14,427.93	1,171,431.22				1,185,859.15	
Manitowoc Shipbuilding Co.		1,014,558.99						1,014,558.99

Summary of amortization allowances of $500,000 or over, as allowed by appraisal section up to April 30, 1925—Continued

Name of taxpayer	Amortization allowed on lowered value in use	Amount based on solicitor's ruling and on S. E. P.	Amount not based on solicitor's ruling	Amount not based on S. E. P. and not specifically condemned by solicitor's ruling	Closed under 1312	Outlawed	Inactive	Open
Mattiessen & Hegler	$96,849.60	$735,505.77	$96,849.60			$832,355.37		
Merchants Shipbuilding Co		1,422,770.58						$1,422,770.58
Mesta Machine Co	624,306.86	230,539.00		$624,306.86			$854,845.86	
Midvale Steel & Ordinance Co		9,330,440.16						9,330,440.16
Moline Plow Co	378,676.26	550,140.32		378,676.26		928,816.58		
Moore Shipbuilding Co	2,308,541.40	2,104,112.54		2,308,541.40				4,412,653.94
Morgan Engr. & Canton Co. (steel foundry)	623,262.06	256,900.89	14,401.40	449,222.84				720,525.13
Morse Dry Dock & Repair Co	1,151,416.83	532,607.23		1,151,416.83		1,684,024.06		
Munson Steamship Line				927,668.08		927,668.08		
National Acme Co	901,751.91	102,000.00		901,751.91				1,003,751.91
National Aniline Chemical Co				9,912,740.08				9,912,740.08
National Malleable Casting Co	988,235.19		988,235.19					988,235.19
Newport Mining Co	663,752.64	521,517.69		663,752.64				1,185,270.33
New York Air Brake Co	397,153.74	1,065,083.90		397,153.74				1,462,237.64
New York Shipbuilding Corporation	1,615,756.41	1,968,539.39		1,615,756.41		3,584,295.80		
Nicholson File Co	678,281.26		678,281.26			678,281.26		
Niles Bement Pont Co	1,113,465.88		232,421.00	881,044.38		1,113,465.38		
Northwest Steel Co				615,762.46		615,762.46		
Norton Co	777,204.14	225,773.16	777,204.14					1,002,977.30
Ohmer Fare Register Co	8,604.93	530,708.90		8,604.93				539,313.83
Ore Steamship Corporation	1,466,389.53	1,466,389.53						1,466,389.53
Oriental Navigation Co		710,883.00						710,883.00
Pacific Coast Shipbuilding Co	535,962.43	362,942.38	80,500.00	654,508.12				1,097,950.50
Pacific Coast Steel Co	410,748.42	604,526.82		410,748.42				1,015,275.24
Pacific Steamship Co	645,264.07	645,264.07				645,264.07		
Pan American Petroleum Transportation Co				1,892,624.96				1,892,624.96
Pierce Oil Corporation	62,466.87	44,453.86	1,348,914.35			1,393,368.21		
Pittsburgh Steel Products	2,535,167.43	161,391.43	2,535,167.43			2,696,858.86		
Pocohontas Fuel Co	607,295.32		607,295.32	246,922.70		854,218.02		
Potters & Johnson Machine Co	91,430.65	410,725.68		91,430.65		502,156.33		
The Pressed Steel Car Co	304,146.18	268,020.88		304,146.18				572,167.06
Procter & Gamble	2,313,503.67	666,912.00	3,330,936.67					3,997,848.67
Pure Oil Co				788,559.59				788,559.59
Pusey & Jones Co		4,007,964.81				4,007,964.81		
Quaker Oats Co	2,583,048.00			2,583,048.00		2,583,048.00		
Ray Consolidated Copper Co	370,233.95	158,604.34		760,706.43		919,310.77		
Republic Iron and Steel Co	3,167,080.22	174,918.51	3,167,080.22					3,341,998.73
Roeblings Sons Co	1,182,725.80		1,182,725.80			1,182,725.80		
Seattle Northern Pacific Shipbuilding Corporation		1,828,664.65				1,828,664.65		

Sharon Steel Hoop Co.	9,712.23	736,999.72				736,999.72		
Sherwin-Williams Co.	372,599.32	218,645.05	372,599.32					591,244.37
Sinclair Oil & Refining Co.		1,476,926.76	759,585.44					2,236,512.20
Skinner & Eddy Corporation		3,027,085.74	1,415,892.35			4,442,978.09		
Solvay Process Co.	774,793.77	146,703.79	763,165.45			909,869.24		
South Porto Rico Sugar Co.				1,009,170.57				1,009,170.57
Southwestern Shipbuilding Co.	1,563,262.62	643,604.13		919,658.49		1,563,262.62		
Sperry Flour Co.	1,027,023.81		1,027,023.81					1,027,023.81
Standard Oil Co. of Indiana	77,911.84	2,349,135.56		527,182.68				2,876,318.24
Standard Shipbuilding Corporation		1,332,141.25		1,032,975.88		2,365,117.13		
Standard Steel Works	574,213.29		574,213.29					574,213.29
The Stanley Works	158,942.36	556,362.65		158,942.36		715,305.01		
Steel & Tube Co. of America		5,232,176.46						5,232,176.46
Sun Oil Co. and Allied companies		1,352.40		2,755,342.46				2,756,694.86
Swift & Co. (Libby, McNeil & Libby)	555,304.45			555,304.45				555,304.45
Swift & Co.	404,019.04	405,334.61	404,019.04					809,353.65
Symington Machine Corporation		696,578.25						696,578.25
Standard Steel Car Co.	2,896,804.24	142,959.10	2,896,804.24			3,039,763.34		
Saginaw Shipbuilding Co.		1,234,763.13				1,234,763.13		
Standifer, G. M., Construction Co.		1,842,991.13		822,224.00		2,665,215.13		
Terry Shipbuilding Co.		1,340,531.49				1,340,531.49		
Timken Roller Bearing Co.	699,244.93	73,568.96	699,244.93			772,813.89		
Todd Shipyards	2,861,312.59	81,790.87	2,861,312.59					2,943,103.46
Toledo Shipbuilding Co.	863,192.62	575,461.75		287,730.87	$863,192.62			
Union Carbide & Carbon Corporation	6,316,956.01	244,796.08	6,316,956.01			6,561,752.09		
Union Construction Co.		1,411,561.26						1,411,561.26
Union Shipbuilding Co.	641,670.81	691,493.15		641,670.81				1,333,16[illegible].36
United Verde Extension Mining Co.	3,322,648.92		3,322,648.92					3,322,648.92
U. S. Steel Co.	28,671,803.71	27,136,899.99	27,926,412.61					55,063,312.60
Utah Copper Co.	2,770,146.53	46,144.98	2,737,491.91					2,783,636.89
Vacuum Oil Co.	373,110.91	1,894,817.78	373,110.91					2,267,928.69
Weirton Steel Co.	616,126.76		616,126.76	1,372,426.74		1,988,553.50		
Western Pipe & Steel Co.		1,440,174.61				1,440,174.61		
Westinghouse Air Brake Co.	1,387,799.97	83,569.27	1,387,799.97					1,471,369.24
Westmoreland Coal Co.		508,093.12						508,093.12
Wheeling Steel & Iron Co.	718,406.16			718,406.16				718,406.16
Whitaker Glessner Co.	2,161,833.66	10,054.99	2,161,833.66					2,171,888.65
Winnett Operating Co.		576,835.27						576,835.27
Worthington Pump & Machinery Corp.	1,724,059.85	176,233.93		1,724,059.85	1,900,293.78			
Youngstown Steel & Tube Co.	3,407,135.98	3,204,511.88	3,407,135.98					6,611,647.86
The Texas Co.		131,527.92	2,300,192.51					2,431,720.43
Total	187,583,994.39	215,256,585.52	138,116,453.66	74,548,906.74	22,597,789.94	117,778,985.43	32,424,563.40	253,120,717.15

COMPROMISE OF TAXES AND PENALTIES

The matter of comprising taxes and penalties deserves congressional consideration.

Mr. Nelson T. Hartson, who was Soliciter of Internal Revenue until March, 1925, stated to the committee (2030).

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.

COMPROMISE OF TAXES

Such authority as is delegated to the Commissioner of Internal Revenue to compromise taxes and penalties is to be found in section 3229, Revised Statutes, which was enacted long before the income tax was imposed. This statute is as follows:

The Commissioner of Internal Revenue, with the advice and consent of the Secretary of the Treasury, may compromise any civil or criminal case arising under the internal revenue laws instead of commencing suit thereon; and, with the advice and consent of the said Secretary and the recommendation of the Attorney General, he may compromise any such case after a suit thereon has been commenced. Whenever a compromise is made in any case there shall be placed on file in the office of the commissioner the opinion of the Solicitor of Internal Revenue, or of the officer acting as such, with his reason therefor, with a statement of the amount of tax assessed, the amount of additional tax or penalty imposed by law in consequence of the neglect or delinquency of the person against whom the tax is assessed, and the amount actually paid in accordance with the terms of the compromise.

This section was construed by the Attorney General of the United States in an opinion published in 16 Opinions Attorney General 249, in which he says:

The authority conferred by Revised Statutes, section 3229, to compromise a case arising under the internal revenue laws does not permit the voluntary relinquishment of a part of a tax lawfully assessed upon and due from a solvent person or corporation. A compromise implies some mutuality of concession, some real doubt about the legality of the claim, or the ability to meet it.

This opinion of the Attorney General in so far as it declares that the commissioner has no authority to compromise a tax legally due from a solvent taxpayer has been followed by the Solicitor of Internal Revenue. (See S. 1371, Cumulative Bulletin, June, 1920, p. 179, and O. D. 799, Cumulative Bulletin, June, 1921, p. 325.)

It has been the policy of the Commissioner of Internal Revenue in cases where he believed that the collection of a legal tax and the enforced payment of the taxpayer's other liabilities would force it into liquidation to compromise such taxes for such an amount as would save the taxpayer from liquidation. In compromising taxes under this policy the question appears to be not how much can the Government collect but how much can be collected without making the taxpayer insolvent.

As the representative of the commissioner at the hearings before this committee, Mr. Hartson says (2043):

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.

Mr. Hartson also stated (2043):

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 slovent and going concern.

The compromise effected with the Atlantic Gulf and West Indies Steamship Co. is a concrete case illustrating the application of this policy.

ATLANTIC GULF AND WEST INDIES STEAMSHIP COMPANY

(2021)

The records of the income tax unit show that this taxpayer resorted to every conceivable fraudulent expedient for the purpose of concealing the immense profits earned by it and its subsidiaries in 1917, 1918, 1919, and 1920, and that these frauds were expressly approved by the directors of the taxpayer. These frauds are set forth in the hearings, beginning at page 2036.

An investigation by the income tax unit was initiated upon the receipt of an anonymous communication which was sent by a former officer of the company. As the result of this investigation, in April, 1923, the taxpayer was notified of a proposed additional assessment of taxes for the years 1917 to 1920, inclusive, amounting to $9,083,033.75 and penalties amounting to $830,808.11. The legality of this proposed assessment of 9,913,841.86 was not questioned.

This tax was compromised for the sum of $1,280,000 cash and the release of a judgment held by a subsidiary of the taxpayer against the United States for $1,351,381.81, or a total consideration of $2,631,381.81.

On May 1, 1923, this taxpayer made an offer to compromise all tax and penalties for 1917 to 1920, inclusive, for $1,200,000, and this offer was increased on July 12, 1923, to $1,500,000 and modified to include 1921.

A report was made by Mr. E. C. Lewis, an accountant for the income tax unit, on June 7, 1923, in which he stated that the true financial condition of the taxpayer could not be determined without a complete audit. Incident to the investigation, which disclosed the unreported income upon which this tax was assessed, the books of the taxpayer had been audited by two revenue agents. This audit did not extend beyond 1920. When the taxpayer's offer of July 12, 1923, was referred to the solicitor, he requested that the revenue agents who had examined the taxpayer's books bring their report down to and including 1921.

On July 20, 1923, these revenue agents made the following report:

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, dicloses 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 motgages 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
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.

Notwithstanding the fact that this tax was assessed upon fraudulently concealed income, it was compromised upon the taxpayer's unverified statement as to its ability to pay, and the compromise was based upon the capacity of the taxpayer to pay without endangering is solvency or ability to continue in active business.

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 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 withou 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. It appears that 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. This examination consumed about 10 days' time. Both Mr. Lewis 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 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.

The consolidated balance sheet of this taxpayer and its subsidiaries as of December 31, 1923, is as follows:

ASSETS, 1923

Capital assets:		
Fleet in commission	$70,425,466.83	
Shore properties	4,104,398.89	
Good will and franchises	12,503,977.37	
		$87,033,843.09
Investment in foreign subsidiaries (Exhibit 2)		2,374,274.62
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		2,616,666.70
Current assets:		
Supplies and repair parts	$347,960.33	
Accounts and notes receivable	6,254,053.89	
Marketable securities	122,675.57	
Cash on hand and in banks	2,064,379.14	
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] 28,706,300.00
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	$4,093,284.70	
Accrued interest on bonds, etc	366,589.54	
Coupons payable	409,912.50	
Intercompany balances (net)		4,869,786.74
Reserves:		
Depreciation of properties	$21,147,687.82	
Replacement of marine equipment	1,520,748.39	
		22,668,436.21
Miscellaneous		16,931,854.01
Surplus		108,498,814.45

From the above balance sheet it will be noted that this taxpayer carried among its liabilities outstanding capital stock amounting to $28,706,300 in addition to reserves of $22,668,436.21 and surplus of $16,931,854.01. This compromise was made on January 2, 1924. On that date the common stock was quoted on the New York Stock Exchange at 15½, which would give the 146,934 shares outstanding common stock a market value of $2,309,974.88. On the same day the preferred stock was quoted at 13⅛, which would give the 137,429

[1] 287,063 shares.

shares outstanding a value of $1,803,755.62, or a total value of common and preferred of $4,113,730.50.

On December 8, 1925, the common stock was quoted at 59¾ and the preferred at 54¾, at which rate the outstanding stock has a market value of $16,303,544.25.

In a letter to Senator McKellar, dated March 5, 1924, and published in the Congressional Record of March 12, 1924, page 4155, the Secretary of the Treasury said:

> 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.

It is evident that with unencumbered liquid assets upon which these taxes were a first lien, amounting to $9,909,427.77, in addition to its equity in ships and other property, it was possible to collect far more than the $2,631,381.81 for which this tax of $9,913,841.86 was compromised.

No contention was made on behalf of the commissioner who authorized this settlement that it was not possible to collect more than the amount paid. The one contention made on behalf of the commissioner was that no more could have been collected without endangering the solvency of the taxpayer.

ARTHUR K. LEWIS

In 1917 this taxpayer made a profit of $2,149,086.12 on the sale of ships, which he failed to report as income. This profit having been disclosed by an examination of the taxpayer's books an additional tax for 1917 of $1,546,341.03 was assessed.

This tax was compromised for $310,000 on the ground that to require the payment of more would force the taxpayer into bankruptcy. At the time this compromise was effected the taxpayer owned stock in various corporations, which were under his management, the book value of which was approximately $3,000,000.

Compromise Policy Illegal

While the Commissioner of Internal Revenue may have observed the Attorney General's construction of section 3229, Revised Statutes, in that he may not have compromised taxes except in cases where the tax and other liabilities might exceed what could be realized on a forced sale of the taxpayer's assets, the reason for that limitation has been entirely ignored.

The Attorney General, in the opinion above quoted, based his limitation of the right to compromise to cases of insolvency upon the proposition that "a compromise implies some mutuality of concession, some real doubt about the legality of the claim, or the ability to meet it." This language clearly implies that the right to compromise stops where doubt as to ability to collect stops. This language clearly means that, while the commissioner is vested with discretion, in determining the maximum amount the Government may be able to collect, and is authorized to compromise for such amount, the commissioner is not authorized to relinquish or forgive any amount of tax which in his judgment the Government may be able to collect but the collection of which would force the taxpayer into liquidation.

The policy of compromising taxes for such amounts as will save the taxpayer from insolvency not only nullifies the provisions of section 3186, giving the Government a lien against all except prior lien holders, but even bars the Government from participating in the distribution of assets among unsecured creditors. The practical effect of this policy is that all other creditors are given priority over the Government's claim for taxes, and the delinquent taxpayer is given an exemption of sufficient capital to keep in business.

If the fraudulently concealed income of a taxpayer is discovered after the taxpayer has suffered such losses that the payment of the legal tax will bring its liabilities above what can be recovered on the forced sale of its assets, this policy declares that such taxpayer shall be relieved of tax upon its fraudulently concealed income to the extent necessary to save it from insolvency. Such a policy places a premium upon concealing income and speculating with the money due the Government as tax, because if a loss results the Government stands the loss.

In the Atlantic, Gulf & West Indies case the stockholders were left with property which had a market value of $4,113,730.50 at the time the compromise was effected and which now has a market value of $16,303,544.25.

Delegating discretion as to how much of a legal tax the Government can collect is one thing. Delegating discretion as to how much tax a taxpayer can pay without becoming insolvent is quite another thing. Congress has fixed the rate at which profits shall be taxed without regard to the solvency of taxpayers. Injecting the element of solvency fixes another standard than that fixed by Congress. An insolvent person or corporation may earn a taxable income, and Congress has not seen fit to exempt from tax income earned either before or after insolvency.

Compromising taxes on the basis of ability to collect is within the power delegated by section 3229, Revised Statutes. Deliberately compromising taxes for less than can be collected is an abuse of discretion and constitutes a voluntary relinquishment without consideration of a debt due the Government. This, the Attorney General has said, the commissioner is not authorized to do. In making such compromise the commissioner has arrogated to himself the function of determining, not what can be collected, but the tax rate at which the taxpayer should be taxed. It is doubtful whether Congress could delegate such authority, and it is clear that it has not attempted to do so.

That the Solicitor of Internal Revenue recognizes that this policy is not authorized by law is shown by the statement of Mr. Gregg before the Ways and Means Committee of the House of Representatives. On page 598 of the hearings before that committee on the revenue revision, 1925, Mr. Gregg says:

> It has been more or less accepted, at least as far back as 1918, as the policy to compromise for the maximum amount which could be collected and leave the company in existence, until fairly recently, when several cases arose, that presented the question again. In connection with these cases we went into the various internal laws to see if we could get an idea from them of the factors that Congress intended we should take into consideration. After consideration of those things it appeared to us that Congress had indicated that we should compromise only on the basis of the greatest amount we could col-

fect, irrespective of the right of other creditors or of the future of the company.

The consideration of the legality of the compromise policy of the commissioner was doubtless brought about by the discussion of the Atlantic Gulf & West Indies Steamship Co. and other compromises before the committee.

KERR NAVIGATION CORPORATION

(3727)

This corporation was organized in 1917 by Messrs. Kerr and Klegg, British subjects, for the purpose of acquiring the interned Hamburg-American Line steamships. In 1919 this corporation disposed of its assets to another corporation controlled by the same people and was dissolved. At the time of the dissolution of the taxpayer negotiations were pending to dispose of the ships to the Harriman interests. At the instance of the prospective purchasers, $1,350,000 was deposited with a trustee to cover any additional taxes that might be assessed.

In August, 1920, the negotiations for the sale of the ships were concluded, and Messrs. Kerr and Klegg, to avoid the payment of tax, tried to induce the Harriman people to deliver the money in China, London, or Spain. This the Harriman people refused to do. The Harriman people notified the agents of the Government of the time and place where the money was to be paid. The revenue agents had learned that Kerr and Klegg had booked passage to leave this country on the day this money was payable. With this information the revenue agents were present when the money was paid and the sum of $5,000,000 was impounded.

Following this attempt to defraud, an arbitrary assessment of $6,580,000 additional tax was made. Upon audit and after every detail of this assessment had been reviewed by the committee on appeals and review, by whom the taxpayer had been sustained on some points, the assessment was reduced to $1,381,530.85.

Following this determination the taxpayer made an offer to compromise for $800,000. This offer was rejected, but the commissioner indicated that an offer of $900,000 would be accepted. Such offer was made and accepted on June 27, 1923.

With $6,350,000 available from which to collect this tax, the question of ability to collect was not involved. This compromise was based upon the theory that if the Government collected more than these defrauding aliens were willing to pay there might be litigation.

The amount of the tax had been passed upon by the committee on appeals and review, the highest appellate body of the Bureau of Internal Revenue, before whom the taxpayer was fully heard.

If this tax was not a legal tax, it should have been reduced and a tax assessed upon which the commissioner was willing to stand. To assess a tax of $1,381,530.85 after full hearing and three years' consideration, with ample funds available out of which to collect it, and to then compromise such tax for $481,530.85 and interest, less than the amount assessed, can not be justified on any theory. If a court found that a litigant was entitled to recover judgment for $1,381,-

530.85, but refused to enter judgment for more than $900,000, a parallel situation would be presented. This is taxation by bargain and not assessment by law. There can be no uniformity of tax unless taxes are assessed in accordance with principles uniformly applied to all taxpayers similarly situated and the tax found due is collected if collectible.

COMPROMISE OF FRAUD PENALTIES

The imposition and compromise of fraud penalties presents a peculiar situation.

Section 275 (*b*) of the revenue act of 1924 provides:

> If any part of any deficiency is due to fraud with intent to evade tax, then 50 per cent of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected, and paid, in lieu of the 50 per cent addition to the tax provided in section 3176 of the Revised Statutes, as amended.

Thus, if the fraud relates to but a small fraction of the income, upon which the deficiency tax is assessed, the penalty is as great as though the fraud related to the entire income upon which a deficiency of tax is found. Furthermore, the law gives the commissioner no discretion to gauge the penalty in accordance with the degree of culpability characterizing the fraud.

If this section of the law stood alone, the congressional intent that a 50 per cent penalty should attach to every deficiency in which the fraud element is present, regardless of the extent or nature of the fraud or the degree of moral turpitude of the taxpayer, would be without doubt.

The Attorney General of the United States had held that section 3229, Revised Statutes, authorizes the Commissioner of Internal Revenue (with the approval of the Secretary of the Treasury) to compromise penalties and interest regardless of the solvency of the taxpayer. (31 Opinions Attorney General 459.)

Ninety per cent of the fraud penalties assessed pursuant to section 275 of the revenue Act of 1924 and similar provisions of the prior revenue acts are compromised under the authority delegated by section 3229, Revised Statutes. (4011.) The practical result is that the provision of section 2775, fixing the amount of the penalty, operates only as a maximum limit on the penalty and no minimum is prescribed by law.

In the J. H. Hillman & Sons case a penalty of $1,888,828.29 was compromised to $100,000, or less than 6 per cent. (4003.)

Mr. Gregg stated to the committee that there was nothing unusual about this compromise. He said: "I am sure that I can dig up other cases where the same thing was done or where the amount accepted in compromise bore a smaller relation to the amount of the penalty than in this case, and I can find some where it has been done in the last month." (4072.)

In the American Blower Co. case (3490) both the income tax unit and the solicitor found that income had been fraudulently reduced by false return of the inventory of the taxpayer, which had been made at the direction of James Inglis, the president of the company. The penalty of 50 per cent was waived upon the payment of additional taxes of $240,824.45 and interest at 5 per cent per annum from March 15, 1919, to December 1, 1923. This action was taken after Assistant Secretary of Commerce Drake and Secretary of the Navy Denby had intervened on behalf of Mr. Inglis.

Refunds, Credits, and Abatements

From the beginning of the fiscal year 1921 to April 30, 1925, refunds amounting to $459,090,825.49 have been made by the Bureau of Internal Revenue.

These refunds may be briefly summarized as follows:

Refunds pursuant to revenue act of 1924, reducing 1924 taxes 25 per cent	$17, 694, 233
Refunds pursuant to Federal court decisions and Attorney General's rulings	148, 278, 828
Refunds pursuant to allowances by Bureau of Internal Revenue	293, 117, 764
	459, 090, 825

In considering these figures the fact must be borne in mind that refunds constitute but a small fraction of disputed allowances made to taxpayers.

DEDUCTIONS TAKEN IN RETURN

If a taxpayer takes a deduction in his return which is allowed by the income tax unit there is no occasion for a refund, credit, or abatement. The larger part of the questionable allowances for amortization, depletion, and depreciation were taken in the returns of the taxpayers, and unless these deductions were disallowed and a deficiency tax assessed neither a refund, credit, nor abatement is involved.

ABATEMENTS

If a deficiency tax is assessed and the taxpayer desires a hearing upon such deficiency before paying the additional tax, a claim in abatement is filed.

CREDITS AND REFUNDS

When a taxpayer claims that the tax paid is excessive, either because the net income shown by his return is excessive or because a deficiency tax is illegal, he may file a claim for a credit or a refund. If this claim is sustained in whole or in part and unpaid taxes of another year are due the Government, the excess tax paid is credited against the tax due.

It is only in cases a tax paid is found to be excessive and there is no tax due for another year that a refund results.

REFUNDS, CREDITS, AND ABATEMENTS EXCEEDING $250,000

A preliminary examination of the allowed claims for refunds, credits, and abatements, exceeding $250,000, has been made by the committee's staff. These allowances aggregate $171,546,416.59 and are classified as follows:

		Per cent
Refunds	$50, 600, 657. 93	29. 5
Credits	15, 125, 048. 33	7. 7
Abatements	107, 820, 710. 33	62. 8
Total	171, 546, 416. 59	100. 0

An examination of the merits of these allowed claims for refunds, credits, and abatements is being made and will be covered by a later report.

A summary of the amount of taxes remitted in allowances exceeding $250,000 and the per cent of the total remitted on each principal ground follows:

Refunds, credits, and abatements of $250,000 and over

Principal basis of allowance	Allowance	Percentage of allowance to grand total
Special assessment	$39,686,500.06	23.13
Increase allowed in invested capital	34,155,615.29	19.91
Allowances for amortization	11,457,030.06	6.68
Duplicate tax tentative and amended return	10,762,174.43	6.27
Inventory losses	7,457,985.62	4.35
Affiliation allowed	7,111,541.51	4.15
Erroneous assessments on dividends taxed at source	5,217,996.77	3.04
Loss on sale of capital assets	4,806,762.60	2.80
Reallocation of income	4,734,770.32	2.76
Additional depreciation	4,056,028.59	2.36
Nonaffiliated	3,417,000.67	1.99
Subsequent year losses charged to prior year's income (sec. 204)	3,271,171.70	1.91
Deduction from income inheritance taxes paid	3,061,285.65	1.79
Exclusion of income from uncompleted contracts	3,048,546.20	1.78
Additional depletion	3,001,155.95	1.75
Abatements to bootleggers	2,097,371.79	1.22
Revaluation of stock received in reorganization	1,908,982.57	1.11
Miscellaneous deductions from income	1,819,742.78	1.06
Income reported by agent not received	1,769,327.36	1.03
Deduction of amount paid to parent company by subsidiary	1,537,945.01	.90
Losses on liquidation	1,304,997.00	.76
Obsolescence allowance	1,289,581.40	.75
Income from tax-free covenant bonds	1,161,611.22	.68
Changing accounting period	1,001,372.22	.58
On ruling that dividends received were not liquidating dividends	879,396.40	.51
Changing books to accrual basis	761,370.42	.44
1916 dividends not subject to excess profits tax	748,916.85	.44
Amended return changed by losses of branches	645,424.76	.38
Alleged error in cost of goods bought for resale	627,998.66	.37
Deductions of prior year's losses	1,296,888.08	.76
Erroneous assessment on accumulated income of trust estate	621,759.34	.36
Creation of special reserves	575,666.66	.34
Taxpayer having no invested capital (sec. 209)	574,656.21	.33
Withdrawals from partnership on incorporation	549,989.39	.32
Exclusion of compensation for cancellation of Government contracts	493,541.52	.29
Foreign taxes paid	483,034.80	.28
Commissions paid to subsidiary by parent company	456,962.38	.27
Correction of income received within the United States	414,450.18	.24
Value of good will deducted from gross income	374,419.05	.22
Dividends paid out of surplus accumulated prior to Mar. 1, 1913	332,258.72	.19
Assessment as trustee, instead of as corporation	322,740.97	.19
Repayments to Government Department	313,630.86	.18
Noncollectible judgments	300,921.16	.18
Assessed as individuals rather than as partnership	293,837.56	.17
Loss of useful value deduction	282,532.55	.16
Misstatement of income	275,444.40	.16
Value of bond of parent company given to subsidiary in excess of value received	274,800.00	.16
Income from completed goods different from estimated on basis of cost	257,054.80	.15
Transfer from trustee to Cestui Que Trust	251,713.50	.15
Grand total	171,546,416.59	100.00

INVESTED CAPITAL AND SPECIAL ASSESSMENTS

These two subjects relate only to the excess profits and war profits taxes which are no longer being imposed. The foregoing summary of refunds, credits and abatements shows that $39,686,500.06, or 23.13 per cent, were based upon special assesments, and $34,155,615.-29, or 19.91 per cent, were based upon increased allowances for invested capital. Thus, while these subjects do not pertain to taxes now being imposed, they are the grounds upon which 43.04 per cent of taxes heretofore assessed are now being remitted.

The time limitation upon the right of this committee to access to the records of the bureau permitted only the most casual examination of these subjects. Such investigation as we were able to make did disclose the fact that may of the allowances being made are in direct violation of the law, and that there is no sound basis for many of the refunds, credits and abatements now being allowed.

List of refunds, credits, and abatements in excess of $1,000,000 each

A. E. Clegg, New York City	$1,828,438.95
H. F. Kerr, New York City	1,818,813.52
John N. Willys, New York City	1,211,035.02
New England Cotton Yarn Co., Boston, Mass	1,029,052.76
Bartlett-Hayward Corporation, Baltimore, Md	2,641,019.39
American Brass Co., Waterbury, Conn	1,372,152.38
Amoskeag, Manufacturing Co., Boston, Mass	2,247,588.98
International Harvester Co., Chicago, Ill	2,293,046.37
P. Lorillard & Co., New York City	1,562,137.92
The Mackey Cos., New York City	4,985,357.22
Arlington Mills, Lawrence, Mass	2,505,604.04
National Aniline & Chemical Co., New York, N. Y	3,035,771.55
Armour & Co., Chicago, Ill	2,251,395.31
Cudahy Packing Co., Chicago, Ill	2,221,101.13
Libby, McNiell & Libby, Chicago, Ill	2,452,102.22
American Locomotive Co., New York	1,876,250.63
Burrows Adding Machine Co., Detroit, Mich	1,531,746.21
American Shipbuilding Co., Cleveland, Ohio	2,085,732.40
Firestone Tire & Rubber Co., Akron, Ohio	2,960,290.98
Amalgamated Leather Cos., New York	1,858,540.66
Plymouth Cordage Co., Plymouth, Mass	2,468,798.17
William J. Haar, Savannah, Ga	1,681,526.97
Security Trust Co. (Estate of Cornelia Curtis) Detroit, Mich	1,363,207.18
Commercial Pacific Cable Co., New York	2,357,492.89
New Jersey Zinc Co., New York	1,440,214.14
Aluminum Co., of America, Pittsburgh, Pa	1,501,277.88
Francis H. Clerque, Montreal, Canada	1,377,188.04
Singer Manufacturing Co., Elizabeth, N. J	1,623,473.92
Commercial Cable Co. of New York, New York	1,537,945.61
Conrad H. Mann (Receiver for Steward Farm Mortgage Co.) Kansas City	3,048,546.20
Schoellkopf Aniline & Chemical Works, Buffalo, N. Y	1,829,141.16
International Shell & Ordnance Co., New York	1,819,009.54
International Loading Co., New York	1,943,170.25
R. J. Reynolds Tobacco Co., North Carolina	1,698,265.47
American Car & Foundry Co., New York	5,209,204.74
Youngstown Sheet & Tube Co., Ohio	3,482,610.51
Pittsburgh Steel Products Co., Pittsburgh, Pa	1,830,227.55
Standard Steel Car Co., Pittsburgh, Pa	1,955,050.95
Gulf Oil Corporation, Pittsburgh, Pa	3,996,080.18
Total	85,929,697.99

Invested Capital

Appraisals for invested capital purposes involve the same questions as appraisals for depletion purposes. The appraisal of natural resources for invested capital and depletion purposes by the income tax unit has been thoroughly investigated and is discussed under the subject "Depletion and valuation of natural resources for depletion and invested capital purposes."

The time limitation placed upon the authority of this committee did not permit a thorough investigation of the audit questions involved in this subject. Such investigation as time permitted was made, and the results are given in this section of this report. While some provisions of the law appear to have been uniformly ignored, and there appears to be gross discrimination with reference to many provisions, our study of this subject has not been sufficiently comprehensive to enable us to make any definite recommendation.

No system of income taxes upon corporations, which is not based upon invested capital, can be said to even approach the ideal, yet it has been generally claimed that the administrative difficulty of determining invested capital required its elimination from the corporate tax system. Our investigation warrants the conclusion, that the most of the difficulties, incident to the determination of invested capital, have been due to the failure of the bureau to observe the plain provisions of the law.

The 1917 act prohibited the inclusion in invested capital of property acquired by a corporation in exchange for its corporate stock, at a value in excess of the par value of the stock exchanged. This provision has been uniformly ignored, with the result that illegal values have been generally allowed for 1917, and a vast amount of unnecessary valuation work has been done.

The 1918 act permitted a valuation of property acquired by a corporation in exchange for its capital stock, in excess of the par value of the stock exchanged only when the value of the property "is shown to the satisfaction of the commissioner to have been clearly and substantially in excess of such par value," and also required the commissioner to keep a record of all cases in which such excess values were allowed. This provision has been almost entirely ignored.

Both the 1917 and 1918 acts contained provisions preventing the inflation of values for invested capital purposes through the reorganization or consolidation of corporations. While sound rulings construing and applying these provisions have been published by the bureau, such rulings have not been uniformly observed, even by the commissioner himself.

In some instances borrowed capital and deferred payments have been included in invested capital in direct violation of both the 1917 and 1918 acts, and losses which had been charged off by the taxpayer have been capitalized as invested capital.

Notwithstanding the decision of the Supreme Court of the United States that unrealized appreciation in the value of property is not to be included in invested capital such appreciation has been allowed in one case to the extent of $10,000,000.

Expired patents have been generally permitted to be carried as earned surplus at values fixed by their original capitalization while in force.

As has been stated, the committee was unable to ascertain the extent of all of these practices because of the lapse of its authority.

STATUTORY LIMITATIONS ON VALUES ADMISSIBLE AS INVESTED CAPITAL

The 1917 excess profits tax law (sec. 207) provides that tangible property acquired by a corporation on or after January 1, 1914, in exchange for stock or shares in such corporation, shall be included in invested capital at its "actual cost value" at the date acquired. "In case such tangible property was paid in prior to January 1, 1914, the actual cash value of such property as of January 1, 1914, but in no case to exceed the par value of the original stock or shares specifically issued therefor," shall be included in invested capital.

This section also provides that "actual cash paid in" and "paid in or earned surplus and undivided profits used or employed in the business, exclusive of undivided profits earned during the taxable year," shall be considered invested capital.

The limitation upon the value of property acquired in exchange for stock, to the par value of the stock issued in exchange therefore has been consistently ignored by all of the Commissioners of Internal Revenue in determining invested capital for 1917.

On page 1334 of the hearings, Mr. Hartson, Solicitor of Internal Revenue, appearing for the bureau, says:

> I want to say in the beginning that the bureau has adopted the policy and the practice, in determining invested capital for the year 1917, when the property was actually acquired prior to January 1, 1914, to include as paid-in surplus any excess value between the par value of the stock and the actual value of the property as they determined it.

Mr. Hartson's statement is substantiated by regulations No. 41, promulgated under the 1917 war excess profit tax act. Article 63 of regulations 41 provides:

> Where it can be shown by evidence satisfactory to the Commissioner of Internal Revenue that tangible property has been conveyed to a corporation or partnership by gift or at a value, accurately ascertainable or definitely known as at the date of conveyance, clearly and substantially in excess of the cash or par value of the stock or shares paid therefor, then the amount of the excess shall be deemed to be paid in surplus. The adopted value shall not cover mineral deposits or other properties discovered or developed after the date of conveyance, but shall be confined to the value accurately ascertainable or definitely known at the time.

In support of this regulation and this practice, it was contended that the law specifically provides that "paid-in surplus" is to be included in invested capital, and that unless property acquired in exchange for stock can be valued for invested capital purposes at more than the par value of the stock exchanged there can be no such thing as paid in surplus. It was argued that there is an irreconcilable conflict between the provision recognizing paid-in surplus as invested capital and the provision limiting the value of property exchanged for stock to the par value of the stock.

Mr. Hartson admitted that this regulation and practice gave no force nor effect to the provision limiting the value of property exchanged for stock to the par value thereof. He took the position that to give practical effect to the act requiring that either the limitation or the provision permitting paid-in surplus must be ignored.

This position is not tenable. When force and effect are given to all the provisions of this section, there is no conflict between the limitation and the recognition of paid-in surplus.

It will be noted that the limitation by its terms applies only to property acquired prior to January 1, 1914, while property acquired on or after January 1, 1914, may be included in invested capital at its actual cash value regardless of the par value of the stock exchanged therefor.

When property is exchanged for shares in a corporation, the shares represent the stockholder's interest in all of the property of the corporation including surplus, paid in or earned. The converse is also true that all of the property of a corporation, including surplus, is represented by its shares outstanding. Whether, for its own accounting purposes, a corporation carries on its books a paid in or earned surplus or carries all of its property as a charge to its capital account is immaterial for the purpose of determining the relation of the value of its property to the par value of its outstanding shares.

Whether an actual paid-in surplus results from the exchange of shares for property depends upon the value which is attributed to the property acquired by the exchanges. If a value in excess of the par value of the shares exchanged is attributed to the property, a paid-in surplus results. If the value attributed to the property is equal to the par value of the stock no paid-in surplus results from the transaction. The 1917 excess tax law, by specifically limiting the value which may be attributed to property exchanged for stock to the par value expressly prohibits the creation of a paid-in surplus by such an exchange prior to January 1, 1914, for invested capital purposes.

It is true that the law specifically recognizes paid-in surplus as an element of invested capital in addition to actual cash paid in.

The bureau's contention ignores the fact that the limitation of the propery value to the par value of the stock only applies to tangible property acquired prior to January 1, 1914, and to good will acquired since March 3, 1917, and as to property acquired since those dates the limitation does not apply. Thus the paid-in surplus, recognized by the law may arise out of exchanges of stock for tangible property since January 1, 1914, and to exchanges of stock for good will since March 3, 1917. Construing this section in accordance with its plain terms, it has no conflicting provisions which can not be given full force and effect.

Several cases called to the committee's attention involved allowances for invested capital purposes greatly in excess of the par value of the stock exchanged for property. These cases are, however, merely illustrative of the kind of allowances made. The extent of this practice can not be judged by these cases. The practice was and still is general to allow values in excess of par value in determining invested capital for 1917. Neither the amount of these values nor the amount of tax lost to the Government can be even approximately estimated.

INVESTED CAPITAL VALUATIONS UNDER 1918 ACT

Section 326 of the revenue act of 1918 qualified the restriction upon the value of property exchanged for stock to the par value by the following:

Actual cash value of tangible property, other than cash, bona fide paid in for stock or shares, at the time of such payment, but in no case to exceed the par value of the original stock or shares specifically issued therefor, 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: *Provided*, That the commissioner shall keep a record of all cases in which tangible property is included in invested capital at a value in excess of the stock or shares issued therefor, containing the name and address of each taxpayer, the business in which engaged, the amount of invested capital and net income shown by the return, the value of the tangible property at the time paid in, the par value of the stock or shares specifically issued therefor, and the amount included under this paragraph as paid-in surplus. The commissioner shall furnish a copy of such record and other detailed information with respect to such cases when required by resolution of either House of Congress, without regard to the restrictions contained in section 257.

It will be noted that the 1918 act is not retroactive, and the 1917 act still governs the determination of invested capital, for the purpose of determining 1917 taxes.

The provision of the 1918 act, requiring the commissioner to "keep a record of all cases in which tangible property is included in invested capital at a value in excess of the stock or shares issued therefor," etc., has been almost entirely ignored. Although such values have been allowed in thousands of cases, the bureau's representatives were able to produce but a small handful of about 200 cards as the record kept. (4061.)

M. Nash, Assistant Commissioner of Internal Revenue, stated to the committee on May 29, 1925, that this kind of cases had been handled by a section which was abolished about two years ago. (4061.)

As I understand it, the records that were kept up to that time became lost in the shuffle, and this is all I have been able to find. After the abolishment of this section I find no records were kept, and this order evidently was lost sight of, until some of these cases came up before the committee last fall. It was called to my attention that it was necessary to keep such a record under the old law, and since that time we have kept a current record of all such cases.

The following cases were called to the attention of the committee as illustrations of illegal and excessive allowances for invested capital:

PHELPS-DODGE CORPORATION

(13345)

The invested capital of this corporation was illegally inflated to the extent of at least $45,000,000 for 1917, which resulted in a loss of tax to the Goernment for that year of $1,969,998.62.

This same $45,000,000 of inflated value was included in the invested capital of 1918 after it was known by the commissioner to be unsubstantiated and excessive, after it had been deducted from 1919 invested capital as excessive, and over the protest of both the chief of the metals valuation section and the chief of the review section of the Income Tax Unit. The excessive allowance for invested capital resulted in a loss of tax for 1918 of $2,506,648.56.

The question of the value of the property is not involved for 1917, because the property in question was received in exchange for $45,000,000 of the capital stock of the taxpayer, and was included in invested capital at a value, as of date of acquisition, of $90,000,000, in direct violation of the 1917 act.

Upon a revaluation of this property by the Income Tax Unit, before the tax for 1918 was determined, it was found that the value of the property did not exceed $45,000,000.

The valuation of this property at $90,000,000 as of date of acquisition for invested capital was allowed to stand for 1918 by the express order of the Secretary of the Treasury (3372) of March 6, 1924.

The fact that the valuation of this property at $90,000,000 as of date of acquisition (December 31, 1908) was excessive by at least $45,000,000 is shown by evidence other than the revaluation by the Income Tax Unit.

The death of one of the members of the partnership from which this property was acquired resulted in litigation in New York over the valuation of this same property for inheritance tax purposes. The property had been valued for inheritance tax purposes as of September 13, 1907, at $13,350,000. It was contended by the State of New York that it should be taxed on the basis of the value attributed to it when exchanged for the stock of Phelps-Dodge & Co. (Inc.) on December 31, 1908. The New York court determined the value to be $13,350,000.

In 1909 the officers of the subsidiary companies filed affidavits with the Bureau of Internal Revenue, as a part of their returns for corporation excise taxes, fixing the value of this property at $45,000,000, and in 1911 Phelps-Dodge & Co. notified its stockholders that the subsidiary companies had written up the value of their ores and plants from $2,579,041.48 to $24,114,045.73, "so that the total value shown on the books will equal the total estimated values at the time of the sale to Phelps-Dodge & Co., December 31, 1908." (3363.)

Notwithstanding the fact that the New York courts had held the value of this property as of September, 1907, was $13,350,000 and that its value as of December 31, 1908, had been declared by affidavits of the officers of the taxpayer on file with the bureau, and by notice of the taxpayer to its stockholders and found by the income tax unit's own engineers to be $45,000,000, the Secretary of the Treasury by letter to this taxpayer's attorney on March 6, 1924, holds that the value of $90,000,000 shall stand for the undetermined taxes of 1918.

POND CREEK COAL CO.

(1958)

This case involved the determination of invested capital for 1917 and subsequent years.

The promoters of this company acquired options to purchase coal lands for $937,780.25. These lands were turned over to the taxpayer in exchange for $1,500,000 of its capital stock. The committee on appeals and review allowed a value of $3,756,920.48 upon these lands for invested capital purposes, or $2,256,930.48 in excess of the maximum fixed by the 1917 act.

These lands lay on opposite sides of a mountain. The lands on one side of the mountain are accessible to the railroad and can be operated. These lands had a sufficient supply to cover 50 years' operations. The lands on the other side of the mountain are not accessible to the railroad, have no other means of transportation, and will not be worked until the exhaustion of the other deposit. The engineers of the income tax unit gave the available accessible lands a value of $135 per acre, or $2,300,000, and the inaccessible lands a value of $35 per acre, or $625,629.55, a total of $1,925,629.55.

The committee on appeals and review, in an unpublished ruling and without giving notice or an opportunity to be heard to the engineers who were familiar with the case, determined that if part of the lands were worth $135 per acre all of the land had that value, and upon that theory allowed a value of $3,756,930.48 upon the entire tract.

UNITED STATES GRAPHITE CO.

(1810)

The property in question was acquired by this taxpayer in 1893 in exchange for $35,000 par value of its capital stock. This property was included in invested capital for 1917 at $307,149.08.

UNION SULPHUR CO.

This taxpayer acquired its property in 1896 in exchange for $100,000 par value of its capital stock. This property was included in 1917 invested capital at $3,000,000. The propriety of allowing $3,000,000 on this property for 1918 and subsequent years is discussed at pages 64 to 70.

FREEPORT SULPHUR CO.

This taxpayer acquired its property in July, 1912, for $450,000 cash and deferred payment of $1.75 per ton on the first 200,000 tons of sulphur mined and 75 cents per ton on the balance of the sulphur mined. This property was valued at $13,375,857 for invested capital purposes.

Inflation of Invested Capital by Reorganization or Consolidation of Corporations

Section 208 of the revenue act of 1917, reenacted and amended in section 331 of the revenue act of 1918, was intended to prevent the inflation of invested capital through the reorganization, consolidation, or change of ownership of corporate property after March 3, 1917.

Section 208 of the revenue act of 1917 provides as follows:

> That in case of the reorganization, consolidation or change of ownership of a trade or business after March third, nineteen hundred and seventeen, if an interest or control in such trade or business of fifty per centum or more remains in control of the same persons, corporations, associations, partnerships, or any of them, then in ascertaining the invested capital of the trade or business no asset transferred or received from the prior trade or business shall be allowed a greater value than would have been allowed under this title in computing the invested capital of such prior trade or business if such asset

had not been so transferred or received, unless such asset was paid for specifically as such, in cash or tangible property, and then not to exceed the actual cash or actual cash value of the tangible property paid therefor at the time of such payment.

Section 331 of the revenue act of 1918 provides as follows:

In the case of the reorganization, consolidation, or change of ownership of a trade or business, or change of ownership of property, after March 3, 1917, if an interest or control in such trade or business or property of 50 per centum or more remains in the same persons, or any of them, then no asset transferred or received from the previous owner shall, for the purpose of determining invested capital, be allowed a greater value than would have been allowed under this title in computing the invested capital of such previous owner if such asset had not been so transferred or received: *Provided*, That if such previous owner was not a corporation, then the value of any asset so transferred or received shall be taken at its cost of acquisition (at the date when acquired by such previous owner) with proper allowance for depreciation, impairment, betterment or development, but no addition to the original cost shall be made for any charge or expenditure deducted as expense or otherwise on or after March 1, 1913, in computing the net income of such previous owner for purposes of taxation.

The question involved can be best presented by the statement of a hypothetical case.

Assume that A, B, and C, respectively, own 50 per cent of the stock of the A company, the B company and the C company. The A and B companies each have invested capital of $100,000, while the C company has an invested capital of $200,000. Thus the combined invested capital of these companies is $400,000.

A, B, and C, after March 3, 1917, agree to organize a consolidated corporation, the A, B, and C consolidated company, to which the property of the three companies is to be transferred, and the stockholders of the old corporations are to exchange their stock in the old corporations for the stock of the new corporation. The stockholders of the A and B companies each receive 25 per cent of the stock of the new company, and the stockholders of the C company receive the remaining 50 per cent.

The A, B, and C consolidated company now claims that prior to the consolidation there has been an appreciation in the value of its assets which the A, B, and C companies could not include in their invested capital, but which should be included in the invested capital of the consolidated company. The question is whether the above quoted sections apply to the consolidated property. If they apply the invested capital of the consolidated company can not exceed the invested capital of the companies consolidated.

It will be noted that A, B, and C each controlled their respective companies before the consolidation, and the stockholders of the three old companies own all of the stock of the consolidated company. There are no new owners of any interest. The stockholders of the old C company own 50 per cent of the stock of the consolidated company.

This question was presented to the advisory tax board in 1919, and passed upon in their recommendation No. 68, which has never been published. This recommendation states:

In the opinion of the advisory tax board the language of the section means at least that the limitation does not apply unless a person or group of persons who had an "interest or control" in a trade or business or property of "50 per centum or more" before the transaction ,retained after the transaction an interest or control in the same trade or business or property of 50 per centum or more.

Their application of the rule above stated, in the case of the Union Carbide & Carbon Co., which was before them, applied to the hypothetical case means that the property acquired from the C company could not be included in the invested capital of the consolidated company, at more than it could have been included in the invested capital of the C company had the consolidation not taken place, but that this limitation did not apply to the property acquired from the A and B companies.

It will be noted that this rule would exclude from all of the property of the consolidated company the application of the limitation if in the distribution of the stock the stockholders of the C company had received less than 50 per cent of the stock of the consolidated company, notwithstanding the fact that all of the persons interested in old companies owned 100 per cent of the stock of the new company.

In 1921 the Solicitor of Internal Revenue ruled that section 331 of the 1918 act, which, as to this question, is identical with section 208 of the 1917 act, applied to all of the property of a consolidated corporation, acquired since March 3, 1917, if a 50 per cent interest in the consolidated company was owned by the entire group which controlled such property prior to the consolidation. Under this construction, the invested capital of a consolidated company could not be increased by the mere act of consolidation, unless at least 50 per cent interest in the consolidated company was acquired by a person or persons, otherwise than through the exchange of stock upon consolidation.

This ruling of the solicitor was published in the bulletin service, and is included in the Cumulative Bulletin I-1, January–June, 1922, at page 394. This solicitor's ruling is the first and only ruling on this particular question ever published by the Bureau of Internal Revenue, and Congress and the public have a right to assume that this published ruling is the construction of this statute, which is being followed in all cases in which this question is involved.

NATIONAL ANILINE & CHEMICAL CO.

Early in the year 1917, the Shoellkopf Aniline Chemical Works (Inc.), and the Becker Aniline & Chemical Works (Inc.), decided to consolidate, and to also acquire the property of the Bengal Products Co., which was owned in equal proportions by the General Chemical Co., the Senret-Solvay Co., and the Barrett Co. To effect this purpose, the taxpayer, the National Aniline & Chemical Co. was organized subsequent to March 3, 1917.

On June 6, 1917, the tangible and intangible assets of the Shoellkopf Aniline Cehmical Works, the Becker Aniline & Chemical Works and the Bengal Products Co. were transferred to the taxpayer.

After the transfers were effected, the taxpayer had common and preferred stock outstanding amounting to $26,870,580.92, of which amount, $3,819,600 was sold for cash, and the balance was issued to the vendors of the property. Thus the former owners of the various properties consolidated retained an 85 per cent interest in the consolidated property and the interest of the Shoellkopf Co. was 55 per cent.

It will be noted that under the published ruling of the solicitor, the provisions of section 208 of the 1917 act limited the amount at which these properties could be carried into the invested capital to the amount of the invested capital which would be allowable to the former owners had the transfer not taken place. Even under the unpublished ruling of the advisory tax board, the property acquired from the Shoelkopf Co. could not be included in the invested capital of the taxpayer at more than it could have been included in the invested capital of the Shoelkopf Co.

The income tax unit assessed the taxpayer for the year 1917 on the basis that its invested capital was limited by section 208 above quoted. To this action the taxpayer protested, and filed a claim for abatement. The question was submitted to the Solicitor of Internal Revenue for his opinion. Solicitor Mapes decided in an opinion (unpublished):

> That the limitations imposed by section 208 of the revenue act of 1917 apply in the computation of the invested capital of a corporation, firm, or a consolidation of several corporations (not originally affiliated) where the constituent corporations receive shares of stock of the new corporation in exchange for their assets and the several constituent corporations retained a control through stock ownership of 50 per cent or more.

Notwithstanding the decisions of the solicitor, the income tax unit settled the case on the theory that section 208 did not limit the invested capital which the taxpayer could claim for the year 1917, and as a result thereof issued certificate of overassessment No. 256698, showing an overassessment for the year 1917 of $3,035,771.55. Under the procedure of the income tax unit the certificate was forwarded to the solicitor's office for examination before final action was taken thereon. It was returned to Deputy Commissioner Batson, under date of June 9, 1922, by letter signed by J. C. Rogers, member of the committee on claims, with the following comment:

> The attached certificate of overassessment No. 256698, prepared for allowance in the amount of $3,035,771.55 in the case of the National Aniline & Chemical Co. (Inc.), of New York, N. Y., for the year 1917 has been examined.
>
> Approval is withheld for the reason that in making the adjustment upon which the certificate is based the limitations imposed by section 208 of the revenue act of 1917 have not been applied in a computation of the taxpayer's invested capital, in accordance with the opinion of the Solicitor of Internal Revenue recently submitted to the commissioner. However, it appears that, notwithstanding the opinion of the solicitor, the commissioner under date of May 27, 1922, advised the representative of the taxpayer that tax-board recommendation 68 was considered to be controlling in this case and that the limitations imposed by section 208 of the revenue act of 1917 were not applicable. It is, therefore, presumed that the allowance will be scheduled without the approval of this office.
>
> Except as noted above certificate is approved.

Notwithstanding the fact that the solicitor decided that section 208 of the revenue act of 1917 was applicable to this taxpayer, in computing its invested capital for the year 1917, the Commissioner of Internal Revenue settled the case on the basis that the said section was not applicable. There was thus included in the invested capital of the consolidated company $11,500,000 of intangible values, not carried upon the books of the predecessor companies.

If this action was correct, the vendor companies were liable for income tax on the profit which they received upon the sale of these intangibles. In relation to this matter Solicitor Mapes, in a memorandum to the commissioner, said:

The third question in this case is whether the several constituent corporations realized income at the time of the exchange from the transfer of their assets to the National Aniline & Chemical Co. in exchange for its stock. My opinion on this question was that the constituent corporations realized income from the exchange measured by the difference between the cost or value as of March 1, 1913, of the property and the market value of the stock received in exchange.

I understand that the legal correctness of my opinion on this point is not questioned but as a matter of policy it is deemed advisable to close the case on the other basis in accordance with which it has been prepared.

This is a matter of policy concerning which I hesitate to express an opinion.

The vendor companies were not taxed on the profit made by them on the sale of the intangible assets above mentioned.

Thus in the month of June, 1922, the Commissioner of Internal Revenue, against the advice of the solicitor, grants a refund of $3,035,771.55, which is largely based upon an allowance, as invested capital, of an excess of the amount allowable to the former owners of this property, and in the same month publishes a cumulative bulletin proclaiming that such a thing can not be done under the circumstances in this case.

From the solicitor's memorandum above quoted it also appears that the tax on $11,500,000 of profit is also waived "as a matter of policy," although the legality of the tax is not questioned.

BORROWED CAPITAL ILLEGALLY INCLUDED IN INVESTED CAPITAL

Both the 1917 and 1918 acts specifically provide that borrowed capital or property can not be included in invested capital. The 1918 act and the published rulings of the Bureau of Internal Revenue provide that liabilities carried in open book account are borrowed capital within the meaning of that term as used in the act.

Section 207 of the act of October 3, 1917, provides that:

As used in this title "invested capital" does not include * * * money or other property borrowed * * *.

Section 326 (b) of the revenue act of 1918 provides that:

As used in this title the term "invested capital" does not include borrowed capital.

The following rulings of the committee on appeals and review and of the Board of Tax Appeals may be cited as authority for the proposition that obligations of a corporation to its stockholders on borrowed capital.

A. R. R. 1004: In this case the net profits, by appropriate resolution of the board of directors, were divided pro rata among the stockholders according to their individual holdings, and credited to their individual accounts on the books of the corporation. No interest was paid on the accounts. The case was referred by the committee on appeals and review to the solicitor for his opinion. He held that the division of the surplus and the crediting to the stockholders of the amounts in question was in fact a dividend, and that the personal accounts were liabilities of the corporation, and consequently could not be included in invested capital of the corporation.

A. R. R. 1062: In this case the corporation credited its net earnings to the personal accounts of its three stockholders. These amounts were left in the business and used by the corporation in conducting its affairs. The committee on appeals and review held that the amounts credited to the stockholders and used by the corporation in conducting its business constituted borrowed capital and consequently could not be included in its invested capital.

A. R. R. 1984: All of the stock of this corporation except five shares was owned by A. In 1909 there was established on the books of the corporation an account designated "A personal account," which was carried under the general head of accounts payable. In 1918 the amount standing to the credit of A in this account was credited to surplus. The committee held that the account was a liability and could not be included in invested capital.

The United States Board of Tax Appeals has decided on this question in two recent decisions. In the case of the Consolidated Electric Lamp Co., Docket No. 555, the two principal stockholders had their salary credited to their accounts. They owned the building occupied by the company, and the rent due from it was also credited to their accounts. On December 31, 1918, the balance of their personal accounts was $45,064.63. Taxpayer claimed this amount, as part of its invested capital for 1919, which was disallowed by the income tax unit on the ground that it was a liability, and this decision was confirmed by the Board of Tax Appeals.

In the case of the Electrical Supply Co., all of the stock of which was owned by three stockholders, Docket No. 710, it was the custom at the end of each fiscal year to credit on the books to the personal accounts of the three stockholders, the entire net earnings for that year. The accounts were named "stockholders" or "individual surplus account." The stockholders had the right to and did draw against such accounts for funds for their personal use, and also had the right to pay into the same amounts obtained by them from sources not connected with the operation of the corporation's business.

In computing its invested capital for taxation purposes the taxpayer included the amount of these accounts. Upon audit of the taxpayer's income tax returns the commissioner disallowed the amounts credited to the personal accounts mentioned above, and the decision was sustained by the Board of Tax Appeals.

That these published rulings can not be accepted as conclusive of the practice of the Income Tax Unit and that there is gross discrimination in dealing with this subject is shown by the allowances to the Star Co., of New York.

STAR CO. OF NEW YORK

This is one of a group of affiliated corporations controlled by Mr. W. R. Hearst.

On December 31, 1903, the Star Co., of New York, was indebted to Mr. Hearst to the amount of $6,119,100.04, representing advances made by the latter. A journal entry was made on December 31, 1903, on the books of the Star Co. closing this account payable into surplus. In 1917, after a lapse of 14 years, this entry was brought to the attention of Mr. Hearst by an accountant who investigated the books. On November 30, 1917, Mr. Hearst addressed a letter to the Star Co. calling its attention to the fact that such entry was unauthorized and requesting that the entry be reversed to show the facts.. Mr. Hearst in this letter states:

"Not only have I never authorized any such entries, but so far as I have been able to ascertain no such authorization was given by the board of directors of these companies. Nor was there any authorization of any entries which would in any way affect the credits which, prior to the making of the entries referred to, stood upon the books in my favor and which represented moneys advanced by me to those corporations.

In 1918 the taxpayer took up the matter of including this indebtedness in invested capital with Doctor Adams, chairman of the advisory tax board, and on March 9, 1918, the latter sent the taxpayer a telegram as follows:

Noninterest-bearing permanent indebtedness of a corporation represented by loan from sole stockholder without fixed time of maturity and not evidenced by written obligation may be treated in the return as invested capital as per letter of this date.

On March 13, 1918, Doctor Adams wrote the taxpayer as follows:

What I meant to convey by the above telegram is that while I have very little doubt about the status of such indebtedness and am willing to have the return of the company concerned made up on the assumption that such indebtedness is part of the capital, the question is nevertheless one which requires careful legal examination, and we must reserve the right to treat this item as a liability rather than invested capital if subsequent examination of legal precedents proves this to be necessary. You will be advised, of course, before any change of this kind is made.

Attention should be called to this item in the return of the corporation, and you may state that I have informally authorized its inclusion tentatively in invested capital.

On the above authority the taxpayer included the Hearst personal account in its invested capital in submitting its returns for the years 1918 and 1919. In the audit the item was disallowed as invested capital by the Income Tax Unit. The taxpayer protested to the disallowance in a brief dated November 12, 1921. As a result of this protest a conference was held on November 18, 1921, at which the question was discussed, but the record does not indicate that a decision was reached.

The next A-2 letter, dated August 11, 1922, to the taxpayer allowed this item of borrowed money as invested capital, referring to the above-mentioned conference as authority therefor. There is no other evidence in the record to show the authority on which this item was allowed as invested capital.

OTHER ILLEGAL AND DISCRIMINATORY ALLOWANCES AS INVESTED CAPITAL IN STAR CO. CASE

The original taxes paid by the taxpayer, the additional assessments proposed by A-2 letters of the Income Tax Unit, and the actual additional assessments made as a result of adjustments determined after consideration of briefs filed by the taxpayer are as follows:

Year	Original tax paid	Proposed additional assessments A-2 letters	Amounts finally determined upon
1917	$65,387.53	$604,610.28	$94,823.18
1918	161,079.55	850,520.40	21,585.03
1919	298,644.38	576,305.94	177,931.11
Total	525,111.46	2,031,436.62	294,339.32

Proposed additional assessments	$2,031,436.62
Amount of final determination by bureau	294,339.32
Tax liability reduced by bureau conferences	1,737,097.30

Among the disputed items which were originally disallowed by the Income Tax Unit prior to the mailing of the A-2 letters and which were subsequently allowed by the conferees are the following:

1. Deduction of $203,964.36 from gross income of taxpayer, which is claimed as a loss upon the liquidation of the German Journal.

The German Journal Corporation was owned 100 per cent by the Star Co. from 1904. Advances were made to it by the latter from time to time, and on January 1, 1918, these advances aggregated $203,964.36. During 1918 the Journal ceased to operate and was liquidated by the taxpayer, as a result of which the latter claims the loss as a deduction from income for that year. This loss is purely intercompany and therefore not deductible in determining consolidated net income, as the consolidated surplus is not affected by such liquidation.

The following rulings are referred to in support of the disallowance of this deduction:

A. R. R. 2455: In this case an account was owed to one subsidiary. In the liquidation of the debtor subsidiary the account receivable was a loss. The committee on appeals and review held that such loss was an intercompany transaction and no deduction was allowable from gross income for taxation purposes on account of the transaction.

A. R. R. 966: In this case it was held by the committee on appeals and review that an account receivable in the liquidation of a subsidiary was an intercompany transaction and should be eliminated in arriving at the net income of the consolidated group.

Solicitor's recommendation No. 4590: In this case Campbell-Morrell & Co. own 100 per cent of the stock of the Citizens' Coal & Supply Co. The parent company had advanced to its subsidiary $27,453.16, which appeared on its records as an account receivable. Upon dissolution of the latter the parent company received in liquidation $2,153.94, thereby reflecting a loss from its advances and investment of $10,000 in 1905 for capital stock of $35,299.22.

It was held that the receipt of the dividend in liquidation reflected a loss, which, however, was an intercompany loss, and the amount was properly added to the net result of the individual operations to obtain the correct amount of the consolidated net income.

It was held, in Solicitor's Opinion 131, that—

Gain is realized on the distribution in liquidation of the assets of a corporation to another corporation which is the owner of all its stock, * * * and is subject to tax under section 10 of the revenue act of 1918 as amended. Where such companies are required to file consolidated returns for the purpose of the excess-profits tax, the liquidation is an intercompany transaction and the gain derived therefrom is not subject to tax under section 201 of the revenue act of 1917.

2. Goodwill of International Magazine Co.:

The taxpayer claims that it has good will, which it acquired with tangible assets, as follows:

Acquired in 1905 in acquisition of Cosmopolitan Magazine Co.—		
For stock	$25,000.00	
For bonds	487,500.00	
		$512,500.00
Acquisition of New Publishing Co. for bonds		941,290.50
Acquisition through Mrs. Hearst in 1914		1,499,982.32
Total		2,953,772.82

Referring to the amount acquired through Mrs. Hearst ($1,499,982.32), the following explanation is made:

On February 28, 1914, Mrs. W. R. Hearst was indebted to the International Magazine Co. in the amount of $1,059,931.88, which amount the corporation carried on its books as an asset. At the same time Mrs. Hearst owned the total stock of the following corporations in the amounts indicated:

World Review Co	$250,000
American Home Magazine	10,000
Harper's Bazaar (Inc.)	10,000
National Magazine Co. (Ltd.)	100,000
Total stock (par value)	370,000

Mrs. Hearst offered to sell her stock of the four companies last above mentioned to the International Magazine Co. in consideration of the cancellation by it of the $1,059,031.88 indebtedness which she owed to it. The board of directors of the International Magazine Co. accepted Mrs. Hearst's offer and proceeded to liquidate and merge the newly acquired companies with the exception of the National Magazine Co., which was a foreign corporation.

The amount of the so-called good will is determined as follows:

Indebtedness canceled	$1,059,031.88	
Less: Paid for foreign corporation not merged	100,000.00	
		$959,031.88
Net deficit of the three companies merged		540,950.44
Total		1,499,982.32

The International Magazine Co. immediately proceeded to charge off to surplus $1,341,607.74 of the so-called good will. For the purpose of increasing its invested capital for taxation purposes, this taxpayer was permitted to reverse this entry and include this $1,341,607.74 in invested capital as good will.

At the time the above-mentioned transaction was executed the three companies merged with the International Magazine Co. showed deficits aggregating $540,950.44. The result of this transaction was the cancellation of an asset carried on the books at $1,059,031.88 and the assuming of liabilities of the three corporations merged of $540,-

950.4[illegible] excess of assets acquired from them, so that its financial cond[illegible] was impaired to the extent of $1,499,982.32.

The three companies merged with the International Magazine Co. had sustained losses for three years prior to liquidation and were insolvent at the time of the merger. It is contended that no good will was or could be acquired by the International Magazine Co. in absorbing these three insolvent corporations which had operated at a loss for three years immediately preceding the merger.

It was not only improper to reverse the entry which the company made at the time of the merger in charging surplus with $1,341,-607.74, but surplus should be further reduced by $158,374.58 in order that the entire loss should be charged off.

3. Paid-in surplus, $2,052,683.01:

The taxpayer claimed and the bureau allowed as paid-in surplus the amount of $2,052,683.01 as representing the value of the tangible assets of the San Francisco Examiner, which was acquired in exchange for capital stock of taxpayer.

The Examiner Printing Co. was incorporated for the purpose of taking over the San Francisco Examiner, which was the personal property of Mr. Hearst and was operated as a sole proprietorship.

A balance sheet of the San Francisco Examiner as at December 31, 1907, immediately prior to transferring the assets and liabilities to the corporation, was submitted, which was made the basis of a claim for paid-in surplus as follows:

Total assets	$3, 145, 785. 43
Total liabilities	299, 313. 61
Net assets acquired	2, 846, 471. 82
Less capital stock issued	500, 000. 00
Paid-in surplus	2, 346, 471. 82

An examination of the balance sheet shows that among the assets claimed in the above total were the following:

W. R. Hearst	$2, 295, 611.30
Los Angeles Examiner	326, 450. 98
Total	2, 622, 062. 28

The Los Angeles Examiner was owned personally by Mr. Hearst, so that both of the above accounts are properly debits of the proprietor's account. The credit side of the balance sheet contains, among others, the following accounts:

W. R. Hearst, capital	$793, 788. 81
Profit and loss	2, 052, 683. 01
Total	2, 846, 471. 82

In order to show a correct statement, the debits of the personal account should have been offset against the credits with the following result:

Total assets claimed	$3, 145, 788. 43
Less: Personal accounts (W. R. Hearst and Los Angeles Examiner)	2, 622, 062. 28
Correct assets	523, 723. 15
Less: Liabilities	299, 313. 61
Net assets acquired	224, 409. 54

No contention was made on the part of the taxpayer that Mr. Hearst ever paid into the corporation the amount of the debit account. It is evident that Mr. Hearst withdrew from the business the amounts indicated as debits to his personal account and that of the Los Angeles Examiner—namely, $2,622,062.28—but the company subsequently claims these amounts as paid-in surplus. The net assets acquired were actually valued at $224,409.54, as shown by the balance sheet, which was less than the par value of the stock issued in exchange therefor and therefore there was no paid-in surplus.

It is inconceivable that the bureau should allow this item as invested capital in view of the facts which appear in the record, stated above.

APPRECIATION INCLUDED IN INVESTED CAPITAL

The published regulations and rulings of the Bureau of Internal Revenue, as well as the decision of the Supreme Court of the United States, construe the term "invested capital," as defined in section 207 of the revenue act of 1917 and section 326 of the revenue act of 1918, as meaning the capital contributed to or paid into an enterprise plus any net profits earned but not drawn out of the business. (Sec. 831–840, regulations 45, A. R. R. 517, Cumulative Bulletin No. 4, La Belle Iron Works *v.* U. S., 256 U. S. 377.)

These rulings and regulations specifically hold that in determining the earned surplus to be included in invested capital due deduction from operating earnings must be made to cover sustained depletion, and that appreciation in the value of the property can not be offset against depletion sustained in determining invested capital is held by the Supreme Court of the United States in the case above cited.

ANACONDA COPPER COMPANY

(3589)

This taxpayer claimed an earned surplus as a part of its invested capital. Depletion sustained prior to December 31, 1916, had not been deducted from operating earnings in computing the invested capital claimed. This depletion was found by the Income Tax Unit to be $35,676,623.55. In determining the invested capital appreciation in the value of the property amounting to $30,000,000 was deducted from the depletion sustained before the depletion was deducted from the operating earnings. The effect of this action was to include $30,000,000 of claimed appreciation in value in invested capital. This action was taken at the direction of Mr. J. L. Darnell, then head of the natural resource subdivision, about March 1, 1920.

Another error in invested capital amounting to $3,471,517.26 arose out of duplicating intercompany holdings.

This company was also permitted to treat its finished product on hand January 1, 1917, as though sold, thus throwing the profit on this material back into the tax year 1916. This item alone reduced its 1917 taxable income $3,889,309.70.

All of these errors, which made a difference of $2,500,921.49 in the excess-profits tax of 1917, were called to the attention of Deputy

Commissioner Bright prior to the expiration of the period within which an additional assessment could be made by a memorandum dated March 1, 1923, from Mr. W. C. Tungate, head of the audit division, having jurisdiction over this case.

In a memorandum dated March 30, 1923, Deputy Commissioner Bright directed Mr. Fay, then head of the natural resource division, to take no action in this case.

Mr. Bright appeared before the committee to explain his refusal to permit the reopening of this case for the correction of these errors. (3683.)

He stated that an order of the commissioner, dated January 20, 1923, prohibited the reopening of cases in the absence of evidence of fraud or gross error. Errors resulting in decreasing a tax by $2,500,000 appear to be gross errors.

Mr. Bright also cited an order of the Secretary that copper-mine valuations were to remain closed except for 1919 and subsequent years. These errors involved no question of valuation.

The third reason assigned by Mr. Bright was that they were under instructions to get cases closed and settled.

Mr. Bright then stated that he closed this case because he believed it had been properly settled, notwithstanding the fact that these allowances violated the regulations and were denied all other taxpayers similarly situated.

Among other reasons assigned by Mr. Bright for his action in this case was the fact that the taxpayer had waived certain claims. Upon being requested to explain what these claims were, Mr. Bright stated that he did not then know and never had known what these claims were.

EXPIRED PATENTS AS INVESTED CAPITAL

It has been the general practice of the Income Tax Unit to permit invested capital to be inflated by "earned surplus" which has been built up by failing to eliminate the value at which expired patents have been capitalized. This practice is expressly authorized by the regulations. (Reg. 62, art. 843.)

This regulation is based upon the theory that during the life of a patent its value becomes converted into good will value, which is not affected by the expiration of the patent.

This regulation and the practice which has been followed under it are contrary to both the specific provisions of the act and to sound accounting principles.

The 1917 act, section 207, in defining invested capital, specifically provides for the inclusion of patents acquired by a corporation in exchange for stock at not to exceed the par value of the stock exchanged therefor.

The same section makes separate provision for the inclusion in invested capital of the value of good will acquired by a corporation in exchange for stock and limits such value to the par value of the stock exchanged therefor, which can not exceed 20 per cent of the entire capital stock. Thus the 1917 act recognizes patents to be something entirely distinct from good will.

PRESSED STEEL CAR COMPANY

(3451)

This case illustrates the operation of this regulation and the effect of this practice.

This taxpayer was organized in 1899 to take over the assets and business of the Schoen Pressed Steel Co. and the Fox Pressed Steel Equipment Co. The authorized capital stock of the taxpayer was $25,000,000, of which $1,500,000 was sold for working capital and the balance, or $23,500,000, was exchanged for the property and business of the old concerns. The valuation of the property acquired for stock agreed upon between the taxpayer and the unit is as follows:

Cash	$1,500,000=	6 per cent
Patents	10,000,000=	40 per cent
Good will	5,000,000=	20 per cent
Other assets	8,500,000=	34 per cent
	25,000,000=	100 per cent

The invested capital for 1917 was determined to be $37,000,000, which consisted of the $25,000,000 paid in as above and an earned surplus of $12,000,000. In computing the earned surplus no deduction was made from earnings to cover the depreciation of the patents included above, but all of which had expired in 1917. Had the $10,000,000 value of expired patents been written off the books, the earned surplus would have been reduced from $12,000,000 to $2,000,000 and the invested capital would have been $27,000,000 instead of $37,000,000.

It will be noted that good will was carried at $5,000,000, or 20 per cent of the outstanding capital. This was the maximum permitted by the 1917 law. The patents had expired and no longer existed as property, but the regulation under which this allowance was made treats expired patents as good will. If these patents are treated as good will, the good will is increased to 60 per cent of the capital, which is three times what the law allows.

Under the 1918 act patents are specifically made intangible property, and intangible property acquired for stock is limited to 25 per cent of the outstanding capital stock for invested capital purposes. Under these specific provisions the patents and good will allowed as invested capital to the amount of $15,000,000 could not be included in 1918 invested capital for an amount in excess of $6,250,000.

Mr. Gregg stated that the practice followed in this case had been followed "in thousands and thousands of cases." (3470.)

Special Assessments

During the years 1917 to 1921, inclusive, when the excess-profits and war-profits taxes were in force, the law provided that taxpayers in certain cases could secure relief under special assessment. When this method is applied it amounts, in simple terms, to disregarding of the taxpayer's invested capital and the computation of the excess-profits tax from the average-profits tax paid by representative concerns in the same industry.

For instance, in the United Verde Extension Mining Co. case, as presented before the committee, it was shown that the statutory tax of this company for the year 1917, computed on the regular basis, would have been $6,050,991.57. By applying special assessment and computing the tax on the average rate paid by five other copper companies the tax of this company was reduced to $2,845,070.37. Special assessment, then, meant a tax reduction of 53 per cent, or $3,205,-921.20, to this taxpayer in the year 1917. (See pp. 3437 and 3438 of hearings.)

The importance of this subject can also be seen from the amount of refunds, credits, or abatements which have been made through the application of this provision of the law. As there are still about 7,000 undetermined cases pending in the special assessment section of the Income Tax Unit, the present importance of this subject is appalling.

Notwithstanding the importance of the subject and the admitted difficulty of a proper application of the provisions of the law, the bureau, as in the case of amortization, has failed to lay down any adequate statement of the principles and method to be applied either by the taxpayers or the auditors of the special assessment section.

The time limitations upon the authority of this committee permitted only a hasty examination of this subject. This investigation did develop the fact that the authority delegated by the revenue acts is being exceeded and abused and that the following conclusions are justified:

(1) The bureau has, without authority, made retroactive the provisions of sections 327 and 328 of the 1918 revenue act in regard to abnormalities of invested capital and income in determining taxes for the year 1917.

(2) No scientific basis has been set up by the bureau for determining when a company is entitled to special assessment.

(3) The grounds for special assessment granted by the bureau are in some cases economically unsound and in other cases result in nullifying those provisions of the act limiting the allowance of good-will values in invested capital, excluding borrowed capital from invested capital, providing for the taxation of gains due to appreciation after March 1, 1913, and providing for the valuations of stock issued on reorganization. In certain cases the results which would be obtained from the application of the war-profits tax are also nullified.

(4) The bureau's methods in administering the special assessment provision of the act have resulted in gross discrimination between taxpayers.

STATUTORY PROVISIONS

Special assessment was first provided for in a revenue act of 1917. This act states as follows in section 210:

That if the Secretary of the Treasury is unable in any case satisfactorily to determine the invested capital, the amount of the deduction shall be the sum of (1) an amount equal to the same proportion of the net income of the trade or business received during the taxable year as the proportion which the average deduction (determined in the same manner as provided in section two hundred and three, without including the $3,000 or $6,000 therein referred to) for the same calendar year of representative corporations, partnerships, and individuals, engaged in a like or similar trade or business, bears to the total net income of the trade or business received by such corporations, partnerships, and individuals, plus (2) in the case of a domestic corporation $3,000, and in the case of a domestic partnership or a citizen or resident of the United States $6,000.

For the purpose of this section the proportion between the deduction and the net income in each trade or business shall be determined by the Commissioner of Internal Revenue in accordance with regulations prescribed by him, with the approval of the Secretary of the Treasury. In the case of a corporation or partnership which has fixed its own fiscal year, the proportion determined for the calendar year ending during such fiscal year shall be used.

It will be noted that the 1917 act provides for special assessment only in the cases where the invested capital of the taxpayer can not be satisfactorily determined.

Section 327 of the 1918 act provides for determining the tax by special assessment in the following four classes:

(*a*) Where the invested capital can not be determined.

(*b*) In the case of foreign corporations.

(*c*) Where a mixed aggregate of tangible and intangible property has been paid in for stock, and the values of the several classes of property can not be satisfactorily determined as at time of payment.

(*d*) Where "the tax if determined without benefit of this section would, owing to abnormal conditions affecting the capital or income of the corporation, work upon the corporation an exceptional hardship evidenced by gross disproportion between the tax computed without benefit of this section and the tax computed by reference to the representative corporations specified in section 328, this subdivision shall not apply to any case (1) in which the tax (computed without benefit of this section) is high merely because the corporation earned within the taxable year a high rate of profit upon a normal invested capital nor (2) in which 50 per centum or more of the gross income * * * consists of gains, profits, commissions or other income, derived on a cost plus basis from a government contract." (Made during the war period.)

It will be noted that there is nothing in the act of 1918 making retroactive the provisions of section 327 permitting special assessment in cases where the invested capital can be determined.

It is, however, the consistent practice of the Bureau of Internal Revenue to ignore this limitation of the 1917 act and to give retroactive effect to the section 327 of the act of 1918. Recommendation No. 326 of the committee on appeals and review says:

If a corporation has paid no salaries to its officers during 1917, or has paid salaries which were unusually low in comparison to the salaries paid to the officers of competing concerns, and thereby created an abnormal condition which seriously affected its net income and tax liability, it may properly receive consideration with a view to determining its excess-profits tax liability for 1917 in accordance with section 210 of the revenue act of 1917.

In the J. H. Hillman case, in which special assessment was allowed for 1917, there was no difficulty in determining invested capital.

GROUNDS FOR SPECIAL ASSESSMENT

Some of the reasons for granting special assessment are listed below:

1. Insufficient salaries paid to officers.
2. Sale of capital assets within the taxable year.
3. Substantial intangible value in a business of small capitalization.
4. A corporation operating with a large amount of borrowed capital.
5. Where respective values of mixed aggregates of tangible and intangible properties paid in for stocks and bonds can not be satisfactorily determined.
6. Foreign corporations.

After it has once been determined that the taxpayer is entitled to special assessment, the tax is always computed in its entirety without any reference to how much difference the abnormality could possibly make in the tax.

As a rule five companies are selected which are in the same line of business as the taxpayer, and, if possible, companies are selected from the same locality and which are about the same size as the appellant company. The five companies selected are termed comparative.

The final determination of tax under special assessment is based on the average per cent of profits tax to net income for the five comparatives chosen. This average per cent is applied to the net income of the appellant company to determine the profits tax, and the normal income tax of 12 or 10 per cent, as the case may be, is added to this profits tax to obtain the total tax.

GROUNDS UPON WHICH BUREAU GRANTS SPECIAL ASSESSMENT

One of the grounds upon which special assessment is most frequently granted is that the taxpayer paid insufficient salaries to its officers.

According to (*d*) of section 327 of the 1918 act, the "exceptional hardship" must be worked on the corporation by the computation of the tax in the ordinary way. While this hardship may be evidenced by "gross disproportion" between the statutory tax and the tax computed by the special-assessment method, this gross disproportion alone is not sufficient ground for such assessment. It must be kept clearly in mind that one of the basic principles of the act is the fixing of the tax according to the taxpayer's ability to pay, and while any tax may be a hardship it can be construed only as an exceptional hardship in view of the general principles governing the whole revenue act, when the taxpayer would be so affected that he is seriously prejudiced in maintaining his business and competing with his rivals in the same industry.

Let us now examine the "exceptional hardship" borne by the taxpayer corporation because it pays too small salaries to its officers.

In the J. H. Hillman Co.'s case the three executives of the company drew salaries of $12,000 each, or a total of $36,000. It was claimed that they should have been paid at least $50,000 each, plus 10 per cent of the net earnings, or a total of $500,000. The company then claims to have paid $464,000 less in salaries to its officers than it should have done. This is claimed to be an "exceptional hardship" to the corporation.

Let us see what this hardship amounts to. The company should have paid its officers $464,000 more in salaries. This saves the corporation $464,000 in expense. The company had to pay tax on this $464,000, which could not be deducted from income. Even in the highest bracket of 80 per cent, with income tax added, the maximum total rate of tax is 82.4 per cent. In this event the additional tax would be $382,336. Then the corporation stands as follows at the end of the year:

Saved on officers' salaries	$464,000
Loss due to additional tax	382,336
Net saving	81,664

In other words, the corporation claims it has suffered an "exceptional hardship" because it has saved $81,664 net cash. The remarkable part of it is that the bureau agrees with the taxpayer.

While the wording of the act definitely states that it must be a hardship on the corporation, it is interesting to note that the hardship is borne entirely by the three principal officers of this company, the small stockholder and the Government, as well as the corporation, all have more equity in the business or receive more money if small salaries are paid instead of the large salaries claimed as proper.

Moreover, if a corporation is allowed special assessment on the ground of insufficient salaries to officers, the corporation not only escapes the tax, but the Government loses the tax which it would secure if their salaries had been paid.

For instance, if in this case the officers had incomes of over $300,000 each, the surtax alone on these additional salaries received would have been $292,320.

We condemn this ground for special assessment. There is no more reason for allowing relief on the basis of insufficient officers' salaries than there is for insufficient wages to labor or low contract price for raw materials.

The bureau, however, defends this basis for special assessment. In their answer dated November 17, 1925, to the committee engineer's report on special assessment they set up the following hypothetical case:

Corporations A and B are engaged in the same business and are competitors. Officers' salaries in this field of industry average approximately 2½ per cent of gross sales, and corporation B pays that amount. Its competitor, corporation A, however, is a closed corporation owned by one man and his immediate family, as a result of which only nominal salaries are paid to its officers. A comparison of the two concerns might appear thus:

	Company A	Company B
Invested capital	$5,000,000	$5,000,000
Gross sales	20,000,000	20,000,000
Cost of goods sold and other deductions except officers' salaries	19,000,000	19,000,000
Officers' salaries	36,000	500,000
Net income	964,000	500,000
Profits tax	368,000	29,100
Per cent profits tax to net income (per cent)	38.25	5.82

Here we would have two concerns exactly alike in all particulars except as to the deduction claimed for officers' salaries.

Now, in the first place, on the bureau's own figures A company has more money left after paying the statutory tax than B company would have, although A company is claimed to pay insufficient officers' salaries.

Company A has the following net profit left after paying the profits tax:

Net income	$964,000
Profits tax	368,800
Net profit	495,200

Company B has left, on the other hand:

Net income	$500,000
Profits tax	29,000
Net profit	470,900

Therefore A company, in spite of paying a much greater tax than B company, has $24,300 more money in the treasury after paying the tax than its competitor. Yet the bureau contends A company has suffered an exceptional hardship. As pointed out, the hardship is to the officers who didn't receive the salaries and to no one else. The law, however, as before pointed out, is dealing with corporations and not with individuals.

Now, suppose for one moment that B company is also a company owned by one man and his immediate family, as in the case of A company, and then let us see how the Government makes out in tax from these two companies and the families which own them. The figures, however, will be kept precisely the same as in the hypothetical case given by the bureau.

COMPANY A AND OWNERS

(Company A has been granted special assessment on basis of comparatives similar to B company.)

Profits tax, company A (5.85 per cent × $964,000)	$56,394
Income tax	108,673
President's salary (A company, $20,000).	
Tax on president's salary (sole income)	2,630
Total tax collected	167,697

COMPANY B AND OWNERS

Income tax, company B	56,268
Profits tax, company B	$29,100
President's salary (B company, $500,000).	
Tax on president's salary (sole income)	323,030
	408,398

It can be seen, therefore, that when company A is granted special assessment the company and its owner have paid less tax in the amount of $240,701 than company B and its owner, to which it was compared, and the *Government has lost this same amount of tax.*

If company A had not been granted special assessment, company A and its owner would have paid $430,614 in tax against a total tax for company B and its owner of $408,398. Is this difference an exceptional hardship?

It is a frightful iniquity to B company and its owner that it has to pay $408,398 in tax when A company and its owner get away with a tax of $167,697 by means of the bureau's methods of special assessment.

This hypothetical case of the bureau serves another purpose. It shows how the effect of the *war-profits tax can be wiped out by special assessment.*

In order to get a profits tax of $368,800 in the hypothetical case set up by the bureau, they must have assumed that company A was a company with no net income for the pre-war period, but in existence for over one year.

In this case the profits tax is computed as follows:

Net income		$964,000
War profits credit	$3,000	
Ten per cent of invested capital	500,000	
		503,000
Balance taxable at 80 per cent		461,000
Profits tax (as shown by bureau)		368,800

Now suppose we have company C with exactly the same figures involved as shown for company A in the bureau's hypothetical case. But suppose this company C had an average pre-war income of $964,000 as in 1918. Then the profits tax would be computed as follows:

Net income		$964,000
Excess profits credit	$3,000	
8 per cent of invested capital	400,000	
Excess profits credit	403,000	
War profits credit	3,000	
Average net income pre-war	964,000	
War profits credit (not used)	967,000	
Excess profits credit used		403,000
Balance		561,000
Profits tax (30 per cent bracket)		168,300

The effect of the war profits tax is then, in this case, about $200,000 increase in tax.

If now, company A and company B are both admitted to special assessment on the grounds of insufficient officers' salaries, they will both pay the same tax. This will then completely wipe out the effect of the war profits tax.

The war profits tax was intended to apply to the taxpayer whose comparative profits for the war period exceeded those of the taxpayer whose profits during the war period were normal. The war profits tax was probably a hardship in itself, but it can not be assumed that Congress intended that the special assessment provision to be so construed as to nullify the provision imposing the tax.

Considered from every angle we contend that the policy of granting corporations relief by special assessment because said corporations pay its officers too small salaries is unsound, illegal, and ridiculous.

SALE OF CAPITAL ASSETS

Another ground upon which special assessment is granted is that the sale of capital assets creates an abnormality in income. For the purpose of determining the tax rate, applicable to profits arising out of the sale of capital assets, comparison is made with the rate of tax paid by corporations which continue in business. It is clear that profits arising out of the manufacture of steel are not comparable with the profits arising out of the sale of a steel plant. In the one case the profit is the result of operating the business, and in the other case, it is the result of disposing of the business.

The mere statement of the proposition demonstrates its fallacy.

EXTRAORDINARY VALUE OF PERSONAL SERVICE

There are several other grounds for granting special assessment, one of which is based on the extraordinary value of the personal services rendered by the officers of the company. This ground is almost too ridiculous to discuss, for it is evident that efficient management of a corporation should not be considered an abnormal condition or one demanding relief from taxation.

The bureau contends, however, that this is a correct basis, not because of efficient management, but because there is a personal service element in the business of certain taxpayers. The revenue act of 1918 (section 200) sets up certain restrictions concerning the right of assessment under the name of personal service corporations. The bureau evidently considers the provisions of this statute too strict, so they proceed to nullify the effect of these restrictions by special assessment. Why did not the bureau ask Congress to amend this section 200 if it was unjust, instead of trying to accomplish that purpose by applying the special assessment provision of the law?

INTANGIBLE VALUES NOT CAPITALIZED

Special assessment is granted where there is a substantial intangible value in a business of small capitalization. There is equity in certain cases on this ground, and we believe that Congress may have intended to relieve such cases.

For instance, we will suppose two companies are doing business in the same industry. These companies are exactly the same and make the same income, but one incorporated at $400,000 par value of stock and the other at $700,000 par value of stock, $300,000 thereof being issued for good will. Now, it is evident that the first company only has an invested capital of $400,000, while the second company can get $400,000 plus 25 per cent of $700,000 equals $575,000. Therefore the first company must pay a much higher rate than the second simply because it did not take good will into account in incorporating. We do contend, however, that when special assessment is granted on this ground that the constructed invested capital should not me increased beyond the 25 per cent limit provided for in section 326 of the 1918 act. All companies have to bear this limitation, and it is unfair to give more relief under section 327 than the ordinary taxpayer gets under the regular case in section 326.

BORROWED CAPITAL

It is conceded also that borrowed capital may constitute a proper ground for extra assessment. There seems to be ample evidence that this was the principal matter in the minds of Congress when writing this provision of the law. We do contend, however, that due allowance should be made for the extent of the abnormality due to this cause, and also for the deduction of interest on this borrowed capital. If the extent of the abnormal condition is taken into account, then allowances will come within reason.

FOREIGN CORPORATIONS

There is, of course, no question as to the use of special assessment in the case of foreign corporations, or where respective values of mixed aggregates of tangible and intangible properties paid in stock and bonds can not be satisfactorily determined, as these grounds are specifically covered by the act.

The following is a list of the refunds, credits, and abatements exceeding $250,000 allowed since July 1, 1921:

Refunds, credits, and abatements exceeding $250,000 through special assessment

[Sec. 210 of 1917 act; sec. 328 of 1918 act]

Name and address of taxpayer	Section	Total refunds, credits, and abatements
W. Beckers Analine & Chemical Works (Inc.), New York, N. Y.	210	$446,625.19
Schoellkopf Analine & Chemical Works (Inc.), Buffalo, N. Y.	210	1,829,141.16
Jos. Joseph & Bros., Cincinnati, Ohio	210	348,757.02
T. A. Gillespie Co., 7 Dey Street, New York, N. Y.	328	600,629.74
Runyon Corporation, 7 Dey Street, New York, N. Y.	328	526,091.69
International Shell & Ordnance Co., New York, N. Y.	328	1,819,009.54
International Loading Co., 7 Dey Street, New York, N. Y.	328	1,010,919.33
American Shell Co., 7 Dey Street, New York, N. Y.	328	1,943,170.25
Pickands Brown & Co., Chicago, Ill.	328	456,256.39
Coca Cola Co., Plum Street and North Avenue, Atlanta, Ga.	210	316,453.36
Rockford Mitten & Hosiery Co., Rockford, Ill.	328	279,713.97
Mass & Waldstein Co., 92 William Street, New York, N. Y.	210	462,038.34
J. F. Duthie & Co., Seattle, Wash.	328	330,385.15
Atlas Crucible Steel Co., Dunkirk, N. Y.	328	788,334.88
R. J. Reynolds Tobacco Co., Winston-Salem, N. C.	328	1,698,265.47
Four Wheel Drive Auto Co., Clintonville, Wis.	210	348,931.60
Theta Oil Co., 76 West Monroe Street, Chicago, Ill.	328	427,615.57
Hecla Mining Co., Wallace, Idaho	210	492,915.80
Allegheny Steel Co., Pittsburgh, Pa.	328	556,553.59
United States Branch of Employers' Liability Assurance Corporation, Boston, Mass.	328	325,270.72
H. W. Johns-Manville Co., Madison Avenue and Forty-first Street, New York.	328	519,000.87
Neuss Hesslein & Co., New York, N. Y.	210	421,378.18
Fulton Bag & Cotton Mills, Atlanta, Ga.	210	352,508.88
Fellows Medical Manufacturing Co., New York, N. Y.	210	280,446.88
Bessemer Coal & Coke Co., Pittsburgh, Pa.	210	261,153.57
The Centaur Co., 250 Broadway, New York, N. Y.	328	368,063.26
Whitaker-Glessner Co., Wheeling, W. Va.	210	353,033.07
Four Wheel Drive Auto Co., Clintonville, Wis.	328	241,334.31
Globe & Rutgers Fire Insurance Co., New York, N. Y.	210	450,011.32
Atolia Mining Co., San Francisco, Calif.	210	256,018.46
Latrobe Electric Steel Co., Latrobe, Pa.	328	426,047.32
Curtis & Co. Manufacturing Co., St. Louis, Mo.	328	278,336.38
E. J. Lavine & Co., Philadelphia, Pa.	210	521,825.00
American Car & Foundry Co., 165 Broadway, New York, N. Y.	328	5,209,204.74
Cleveland & Western Coal Co., Cleveland, Ohio	210	457,324.44
Lindsay Light Co., 116 East Grand Avenue, Chicago, Ill. (fiscal year)	328 210	316,890.33
Youngstown Sheet & Tube Co., Youngstown, Ohio	210	3,482,610.51
Northwest Steel Co., Portland, Oreg.	210	923,235.81
Select Pictures Corporation, New York, N. Y.	328	384,475.17
Carbon Steel Co., foot Thirty-second Street, Pittsburgh, Pa.	328	$559,039.14
New Jersey Worsted Spinning Co., Garfield, N. J. (fiscal year)	328 210	401,577.98
The Otis Steel Co., 1140 Leader News Building, Cleveland, Ohio	210	398,629.35
Jobbers Overall Co., Lynchburgh, Va.	328	331,981.62
J. B. Inderrieden Co., 332 River Street, Chicago, Ill.	328	265,372.04
Bartlett-Hayward Corporation, Baltimore, Md.	328	1,443,735.21
Gans Steamship Lines, 12 Broadway, New York, N. Y.	328	508,285.10
West Virginia Coal Co. of Missouri, St. Louis, Mo.	328	402,458.00
Whitney Blake Co., New Haven, Conn.	328	337,332.02
Electric Storage Battery Co., care of J. M. Haynes, attorney, Investment Building, Washington, D. C.	328	640,188.12
Kokomo Steel & Wire Co., Kokomo, Ind.	210	282,426.05
W. and A. Fletcher Co., Hoboken, N. J.	328	388,526.84
J. C. Penney Co., 354 Fourth Avenue, New York, N. Y.	210	468,246.88
Pittsburgh Steel Products Co., Pittsburgh, Pa.	328	1,830,227.55
Hartford Machine Screw Co., Hartford, Conn.	210	914,497.97
Total		39,686,500.00

R. J. REYNOLDS TOBACCO CO., WINSTON-SALEM, N. C.

The above company has been allowed abatements and credits amounting to $1,698,265 for the year 1918. Their statutory tax would have amounted to $10,226,521; this has been reduced under section 328 to $8,528,256. The percentage of final profits tax to net income amounts to 40 per cent. From the list of comparative tobacco companies available from the records of the bureau we find that eight tobacco companies paid a higher rate of tax than 40 per cent. If we remember that this was a war year, in which the industries were supposed to be taxed to the utmost, we can not see an exceptional hardship for a company which makes practically $18,000,000 to pay 50 per cent of this in profits tax. If it had not been intended by Congress for anybody to pay this rate, why were the 65 per cent and 80 per cent brackets established at all?

AMERICAN CAR & FOUNDRY CO., NEW YORK, N. Y.

This company has been refunded and abated under section 328 of the act of 1918 the amount of $5,209,204 on account of its 1918 tax. The net income of this taxpayer was $37,443,246, the final profits tax under special assessment was $17,244,552, the final percentage of profits tax to net income amount to 46 per cent.

We would call attention to the fact that the United States Steel Corporation, an allied industry, was in the 80 per cent bracket in 1918 and was assessed a total tax amounting to about 57 per cent of their net income. We do not believe that it was the intent of Congress to hand back these large companies an amount of $5,000,000 on account of their excessive war profits. The data submitted by the department shows that 95.44 per cent of the net income of this taxpayer came from war contracts, but it does not state whether they were on the cost-plus basis or not. We wish to draw attention to that section of the act which provides that corporations "in which 50 per centum or more of the gross income * * * consists of gains, profits * * * derived on a cost-plus basis from a Government contract," is excluded from a right of treatment by special assessment. Whether or not this company is technically excluded we do not know, but we do think that the general intent of the provision was not to grant relief to such companies.

YOUNGSTOWN SHEET & TUBE CO., YOUNGSTOWN, OHIO

This company has received refunds, credits, and abatements amounting to $3,482,610 from a statutory tax amounting to $19,469,794. The consolidated net income of this company was $38,977,014. The above allowance was for the taxable year 1917.

It appears that this claim was originally disallowed by the unit but was allowed by the committee on appeals and review. It would appear that the invested capital of the taxpayer could have been determined and, in fact, was determined. As contended several times before in this report, we do not admit that the policy of the bureau in making retrospective provisions of the 1918 act concerning abnormality is sound for the year 1917.

NORTHWEST STEEL CO., PORTLAND, OREG.

It is interesting to note that for the year 1917 this corporation's taxes have been reduced from $1,380,692 to $457,456 by refunds, credits, and abatements of $923,236 under special assessment. The invested capital of this company for 1917 could have been determined without difficulty, and the remission of this tax was absolutely without legal authority.

PITTSBURGH STEEL PRODUCTS CO., PITTSBURGH, PA.

This company has received a relief in taxation amounting to the difference between the statutory tax of $4,698,161 and a tax determined under special assessment of $2,867,934, a net refund to the company of $1,830,227 for the year 1918.

These figures speak for themselves, but it might also be noted that this company received an amortization allowance which reduced their net income by $2,051,215.

The above cases show plainly the very large measure of relief afforded companies by the bureau's method of determining the tax under special assessment.

Organization and Procedure

Congress has fixed the rates at which net incomes shall be taxed. It has, in general terms, defined net income, yet, in providing what shall be included in and deducted from the income of the taxpayer for the purpose of arriving at taxable net income, the provisions of the revenue acts are necessarily so broad and general that the determination of the amount of the tax is, in many instances almost entirely dependent upon the administrative interpretation and application of the law.

All discretion under the revenue act is vested in the Commissioner of Internal Revenue, yet so great is the volume of income-tax returns that, except in very exceptional instances, individual cases can not be brought to his personal attention. The application of the law to individual cases must of necessity be made by the subordinates of the commisisoner who number several thousands.

It is realized that the nature of the work of the Income Tax Unit is such that the human element will always be the predominant factor. It is believed, however, that the organization and system of procedure must be so modified as to protect the interests of the Government, to insure greater uniformity and a better opportunity for the taxpayer to understand his rights and obligations under the law, and to reduce the opportunity for human error.

DIVISION HEADS SUPREME

The work of determining tax liability may be generally divided into two classes—engineering and audit.

All cases in which the taxpayer claims depletion or amortization are referred to the engineering division for the determination of the depletion or amortization allowances. Where the determination of invested capital involves a valuation of a natural resource, such valuation is also made by the engineering division. When these allowances have been determined by the engineering division such cases are passed to the appropriate audit division, where all other questions are passed upon and the tax is determined.

The work of auditing tax cases is divided among several audit divisions. Individual returns are audited by the personal audit division. The consolidated audit division has jurisdiction over the affiliated corporations, and the corporation audit division has jurisdiction over the nonaffiliated corporations. These audit divisions are divided into sections.

REVIEW OF WORK

In each audit division there is a review section, the function of which is to review the work of the various audit sections in the division. In the engineering division the work of the engineers is reviewed in the section which has jurisdiction over the case.

It will be noted that the head of the division has jurisdiction over the review of the work done in his division.

If a taxpayer is dissatisfied with an allowance made by the engineering division or the allowances and determination of tax by the audit division in which his case is handled, he has a right to appeal. If, however, the taxpayer is satisfied with the allowances made by the engineering division and with the tax as determined by the particular audit division involved, there is no further review of his case unless it involves a refund of $50,000 or more, in which event the certificate of overassessment must be submitted to the solicitor for approval. While refunds which the solicitor has refused to approve have been allowed and paid, the refusal of the solicitor to approve a refund brings the case to the attention of the commissioner. The refund to the National Aniline & Chemical Co., which has been discussed under the subject "Invested capital," is such a case.

While the heads of the engineering and audit divisions may call upon the "rules and regulations section" or the solicitor for a ruling on a question of law, they are not required to do so. (3624.) If the ruling of the head of a division is satisfactory to the taxpayer, even though it may be upon a novel question not covered by any published ruling, or even though it may be in direct conflict with the law, the regulations, and every published ruling on the subject, there is no way under the established procedure for this case or this ruling to be brought to the attention of any superior authority or to ever reach publication, that other taxpayers may claim the benefit of it.

Except in cases involving a refund of $50,000 or more, all of the authority vested by law in the Commissioner of Internal Revenue is exercised by the head of a division upon whose action there is no check, unless the taxpayer is dissatisfied. The case of the Robert Dollar Co. affords a striking illustration of the absolute unlimited power vested in the division heads and the total absence of any check upon the exercise of that power.

ROBERT DOLLAR CO.

In 1916 an American syndicate had a contract with the Russian Government to furnish shells. This contract was turned over to a Canadian manufacturer who agreed to pay the syndicate 70 cents per shell paid for by Russia. The taxpayer was the agent of the syndicate to collect the payments to be made by the Canadian manufacturer to the syndicate, and the taxpayer's compensation was fixed by contract at a percentage of the collections made by the taxpayer on behalf of the syndicate.

It will be noted that under this arrangement the taxpayer's income was not earned until the payments were made. The taxpayer's commissions amounted to about $100,000 on payments made in 1918. These commissions were not returned as income until 1920. When the taxpayer found that it could not maintain the position that these commissions were 1920 income, it took the position that it kept its books on the accrual basis and that the commissions accrued in 1916. The fact was that these commissions were not entered upon the taxpayer's books in 1916, and under its contract they were not earned until 1918, in which year they were paid. There was no possible theory under which these commissions could be considered the income of any year except 1918.

The auditor who audited this case treated these commissions as 1918 income. A conference was had with the taxpayer as the result of which Mr. Lohman, the division head, took the case away from the auditor and closed it, treating the commissions as 1916 income, without submitting the case to the review section.

There was no way for this case to come to the attention of any higher authority unless the auditor had protested over the head of his division chief. The efficiency rating of this auditor, his chances of promotion, and liability to discharge were all under the absolute control of this division head, and if this auditor had any desire to hold his position, to say nothing of being promoted, it was necessary for him to keep silent.

PROTESTS OF SUBORDINATES DISCOURAGED

Notwithstanding the fact that under the established procedure the Commissioner of Internal Revenue and the officers of the income-tax unit, superior to the division heads, are absolutely dependent upon protests from the subordinates of these division heads for information as to irregularities, it has been and now is the policy of the Commissioner of Internal Revenue to discourage such protests and to make examples of subordinates who make them.

The case of Mr. John H. Briggs, former chief of the nonmetals valuation section of the engineering division, is an example of what happened to an able, conscientious engineer who sought to protect the interests of the Government.

JOHN H. BRIGGS

Mr. Briggs, an engineer and a graduate of Yale, entered the service as an auditor. His work attracted the attention of Mr. Hamilton, then head of the metals section, who caused him to be transferred and promoted to the position of appraisal engineer. Mr. Briggs was successively promoted to the position of assistant chief and then chief of the nonmetals valuation section.

Mr. Nash, assistant commissioner, testified that the work under Mr. Briggs's direction had been so nearly disposed of that it was possible to consolidate his section with the metals valuation section.

A most thorough examination of the work of the nonmetals valuation section while under Mr. Briggs's direction failed to disclose a single case in which the determination of that section was not sound and proper. Our investigation did disclose several cases in which Mr. Briggs had been overruled by the head of the engineering division, a special conferee working directly under the head of the engineering division, and the committee on appeals and review, and most ridiculous results determined. Some of these cases have been reviewed in the depletion section of this report. The harmful results of these determinations were not confined to the cases involved, as they established precedents which, if followed, would upset the sound principles being followed in the nonmetals section and which, if not followed as precedents, would result in gross discrimination.

Mr. Briggs filed a protest against the determination of the committee on appeals and review in the Penn Sand & Gravel case and against the action of the conferee in the Climax-Fire-Brick Co. case. In response to his protest in the Penn Sand & Gravel case he received a memorandum from S. M. Greenidge, head of the engineering division, which concludes as follows:

> It is my opinion that the above-named case should be closed in accordance with the instructions of the committee on appeals and review, and also that something be done to curb the tendency of engineers toward taking issue with the decisions or instructions of their superior officers. (1405.)

For some time the amortization allowances were handled by the nonmetals section. While Mr. Briggs was chief of this section, he was not permitted to see the reports to which his name was signed. (4105.)

Mr. Briggs finally laid the whole situation before Mr. C. B. Allen, Assistant Deputy Commissioner, who advised him "to keep still and leave things run along as smoothly as possible." (4105.)

After the Penn Sand & Gravel case, the Climax-Fire-Brick case and other cases, against the determination of which Mr. Briggs protested, were presented to this committee, they were ordered reconsidered by the commissioner, and upon reconsideration Mr. Briggs was sustained. (4071.) Notwithstanding the fact that Mr. Briggs's protests in these cases have saved the Government an immense amount of tax, he was summarily dismissed on April 23, 1925, in the interest of economy.

This investigation disclosed the fact that the chiefs of the metals, coal, and timber valuation sections of the engineering division were exceptionally capable men, who have consistently tried to protect the Government from the unsound bargaining policy which has been pursued in the Income Tax Unit. Since the conclusion of our hearings every one of these men has been removed from the executive position he held.

The dismissal of Mr. Briggs, the resignation of Mr. Tanner, chief of the timber section, and the demotion of Mr. Grimes, chief of the metals-valuation section, and Mr. Davis, chief of the coal section, stand as examples of what happens to employees of the Income Tax Unit who protest against the action of their superiors.

NO COMMMUNICATION EXCEPT THROUGH DIVISION HEADS

The office practice requiring all official communications from any subordinate to a superior of a division head to be transmitted through the division head is effective in preventing anything reaching the commissioner, deputy commissioner, or solicitor which the division head desires to keep from him.

WILLIAM BOYCE THOMPSON

(2134)

This case shows how the cooperation of two division heads can result in releasing a taxpayer from tax, notwithstanding the efforts of conscientious employees to bring the facts to light.

In reporting his income for 1918 this taxpayer claimed losses on the sale of stocks and bonds and on the reduced value of foreign exchange aggregating $597,479.66. He failed to furnish the information called for by the schedule, and which was necessary to audit these claimed deductions. This information was called for but never received, yet the deduction was allowed in a letter dated October 17, 1923, assessing an additional tax of $482.16.

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. An agreement to sell this property 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 tax 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, dated February 12, 1924, was sent out, assessing a tax of $573,011.72, based upon the disallowance of the deduction 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.

On February 28, 1924, representatives of McConnell and Thompson had a conference with Mr. Alexander, head of the natural resource audit division. 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 giving 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.

At this conference Alexander agreed that the losses claimed on stock sales could not be reconsidered, notwithstanding the fact that Alexander knew that this taxpayer had concealed his profit on the mining lands and had not substantiated the loss on stock sales. Alexander also assumed jurisdiction over the matter of the profit on the sale of the mineral lands, although that was a matter over which the metals valuation section of the engineering division had exclusive jurisdiction.

Mr. Grimes chief of the metals valuation section, learned that Alexander had assumed jurisdiction of this case, and on April 14, 1924, addressed a memorandum to his superior, S. M. Greenidge, head of the engineering division, in which he protested against Alexander taking jurisdiction of and attempting to settle a case involving the value of mineral property without consulting the engineers who had jurisdiction of the case and all of the facts with reference to the value and the undisclosed profit. Grimes never received a reply to this memorandum.

A question of law as to whether a part of the profit had been realized in 1917, and was therefore barred by the statute of limitations unless fraud was involved, had been raised. Mr. Grimes directed one of his engineers to consult the solicitor's office on this question. The solicitor's office requested a memorandum covering all of the facts in the case. This memorandum was prepared, addressed to the solicitor, and forwarded by Mr. Grimes to his superior, Mr. Greenidge, on April 28, 1924. This memorandum was turned over by Mr. Greenidge to Mr. Alexander and never reached the solicitor.

Later the engineer who consulted the solicitor's office was reprimanded by Mr. Shepherd, a special conferee working directly under Greenidge, for exceeding his authority, and was directed to prepare a memorandum holding that the profit received in 1917 was barred by the statute of limitations.

SILVER CASES

The silver situation presents another glaring illustration of the operation of the practice which required all communications to be routed through the head of the division.

On June 8, 1924, Mr. Grimes, chief of the metals valuation section, addressed a memorandum to Commissioner Blair, calling his attention to the erroneous and excessive valuations which had been placed on the silver mines, the loss of tax to the Government, and the discrimination against producers of silver with copper and against all other metal industries. This memorandum was left at the office of Mr. S. M. Greenidge, head of the engineering division, to be forwarded by him to the commissioner. As the statute of limitations barred assessments for 1919 after March 15, 1925, it was important that the commissioner act upon this matter promptly. Mr. Grimes never received a reply to this memorandum.

On February 25, 1925, Commissioner Blair informed Mr. L. H. Parker, chief engineer for this committee, that he did not recall ever having seen Mr. Grimes's memorandum of June 8, 1924.

It is self-evident that so long as the heads of divisions are empowered to determine the principles applicable to the disposition of tax cases, and to either make settlements directly or through men under their supervision, and to also rate, discipline, promote, demote, and dismiss the auditors and engineers, such division heads will each be the monarch of his own division, upon whose acts there can be no check, so long as the taxpayer is satisfied.

The authority to hear taxpayers' protests and to determine principles and their application should be vested in officials designated for that purpose by and directly responsible to the Commissioner of Internal Revenue.

Under the present system of procedure there is no possible way for anyone above a division head to know how any case has been settled, unless the taxpayer is dissatisfied and takes an appeal, or unless the case involves a refund of $50,000 or more, or unless an auditor or engineer risks his position by calling the case to the attention of a superior of the head of the division.

It is absolutely essential to the protection of the interests of the Government that the administration of the work and personnel be entirely divorced from the quasi judicial determination of principles and the settlement of controverted cases.

PUBLICITY OF PRINCIPLES AND PRACTICES

Many of the principles, practices, methods, and formulae applied in determining taxes have never been reduced to writing, and only about 15 per cent of the formal written rulings have ever been published.

This failure to promulgate and publish the principles and practices to be followed in determining tax liability has resulted in gross discrimination between taxpayers similarly situated. Taxpayers desiring the benefit of the most favorable practices have been forced to employ former employees of the Income Tax Unit and pay immense fees for information which should be freely available to everybody. The premium thus placed upon the value of unpublished information is the cause of the immense turnover among the employees of the unit and creates a necessity for salaries entirely out of range with what the Government pays for similar services in other bureaus.

This failure to promulgate and publish adequate rulings has retarded the settlement of the law and practice of the department. This unsettled condition of the law and practice has encouraged the filing and prosecution of claims and requires the continued discussion and consideration of questions which should have been long since disposed of by established precedents.

PUBLISHED RULINGS NECESSARY FOR UNIFORMITY

Uniformity in the taxation of those similarly situated is the first and fundamental requisite of any just system of taxation. Such uniformity can not be accomplished unless tax liability is determined in accordance with principles uniformly applied.

The most serious defect in the administration of the income tax law is the absence of any adequate statement of the departmental construction of the provisions of the law, the principles, formula, and methods applied, and the practice and procedure followed in determining tax liability.

The promulgation of such information for the guidance of the thousands of employees of the Income Tax Unit is absolutely essential to the uniform treatment of taxpayers. Complete information as to how his tax is to be computed should be available to every taxpayer, that all taxpayers similarly situated may claim and insist upon the benefit of any principle or practice applied to any of them. Furthermore, such information should be available to Congress, that it may know how the tax laws enacted by it are interpreted and applied and intelligently judge of the advisability of or necessity for amendment.

COMMISSIONER'S APPROVAL

By vesting all discretionary powers under the revenue acts in the commissioner, Congress clearly evidenced an intention to hold him solely responsible for the exercise of all delegated powers. If the commissioner is to exercise the authority vested in him by the revenue acts, and is to be responsible for the administration of the law, all rules interpreting the law and providing for its application to particular cases should be personally approved by him in writing.

While it may be assumed that Congress did not intend that the commissioner should pass on individual cases, it must be assumed that the revenue acts do contemplate that he shall determine the principles, rules, and formula which shall be applied by his subordinates. If this task is too great to be performed by one man, Congress should create a board or commission of several members to exercise the authority now vested in the commissioner.

TAXPAYERS ENTITLED TO KNOW HOW LAW IS CONSTRUED AND APPLIED

Every taxpayer should be able to definitely compute his own tax and to claim the benefit of any ruling or practice applied to another similarly situated. It is therefore manifest that all rules and precedents interpreting and applying the law should be published and available to all taxpayers. Availability to the public of the rules and precedents of the Income Tax Unit is the most effective means of securing the desired uniformity. With such information available, a taxpayer is in a position to claim and contend for the same treatment which has been accorded others similarly situated, and the publication of rulings would be the most effective deterrent against making rulings which should not be treated as precedents.

CONGRESS SHOULD KNOW HOW LAW IS CONSTRUED AND APPLIED

When Congress reenacts a statute which has received executive interpretation it is considered to have given implied legislative approval to such interpretation. During the hearings it was repeatedly claimed that by reenacting the provisions of the revenue acts Congress has affirmed the administrative construction. It is therefore of vital importance that Congress have the means of informing itself as to how the revenue acts are construed and applied. Unless the practices and precedents interpreting and applying the revenue laws are reduced to writing and published, Congress has no means of learning what it is presumed to know in acting upon revenue legislation. Without knowledge of the administrative interpretation and application of the revenue acts Congress can not intelligently determine the desirability or necessity for their amendment.

THE REGULATIONS

The income tax law is necessarily most general in its terms and empowers the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, to promulgate "regulations" more particularly defining the taxpayer's rights and obligations under the law. It was doubtless the intention of Congress that these regulations should be sufficiently complete, comprehensive, and specific to enable any taxpayer to determine his own tax liability.

The regulations under each revenue act must be promulgated before the returns made under such act are prepared. It has been impossible to foresee the multitude of questions which would arise under a new law or under new provisions of subsequent acts. The "regulations" under the earlier acts were, therefore, of necessity, very broad and general, and in many cases were mere restatements of the income tax law. We now have an entirely different situation. It is over seven years since the 1917 returns were filed, and it is extremely doubtful if many questions can arise which are not presented by the returns filed since March, 1918.

Most questions which can arise have been acted upon in some manner, and, if uniformity and consistency of ruling is to be observed, this accumulated mass of precedent constitutes a fund of information which should be available to the employees of the bureau and to the taxpaying public. This information should also be available to Congress. It is only by examining such precedent that Congress can determine how its acts are construed and applied, and whether amendment is necessary or desirable.

Notwithstanding the fact that nearly every conceivable question which can arise under the income tax laws has been presented by returns on file, and some action has been taken upon the most of such questions, the "regulations" promulgated under the 1924 act are still so broad and general as to give the employees of the Income Tax Unit, the taxpayers, and the Congress but little more guidance and assistance than do the "regulations" promulgated under the 1918 act.

PUBLISHED RULINGS

The generality of the regulations leaves a multitude of questions, as to the interpretation of the law and the regulations, to be passed upon in particular cases. In many instances taxpayers before filing returns write to the unit requesting rulings upon the application of the law to particular facts. These inquiries are referred to what is known as the rules and regulations section, where they are answered. When, in the judgment of the rules and regulations section, these answers cover questions not covered by published rulings, they are forwarded to the solicitor for his approval, and, if approved, become what are called income-tax rulings.

The advice of the rules and regulations section is sometimes also sought by the audit and engineering divisions upon matters pending in the unit. It is the practice of the rules and regulations section to answer inquiries from the unit divisions, if the question is covered by a published ruling, but otherwise to refer the questions to the solicitor for a ruling.

Solicitor's rulings are made upon questions referred by the rules and regulations section upon cases brought to the solicitor's office on appeal by the taxpayer, upon refunds involving over $50,000, and upon requests made by the commissioner or deputy commissioner, upon their own initiative, or upon the suggestion of a chief of a division.

For a time the tax advisory board recommended methods of procedure and formula and acted upon cases appealed by taxpayers. The committee on appeals and review was the appellate body to which appeals were taken from unit determinations until it was abolished, when the Board of Tax Appeals was created under the revenue act of 1924.

ONLY 15½ PER CENT OF FORMAL RULINGS PUBLISHED

As of March 6, 1925, there had been issued by the solicitor, the tax advisory board, the committee on appeals and review, and by the rules and regulations section 20,311 rulings, of which only 3,168, or 15½ per cent, had been published.

The number of rulings issued by each of these authorities and the number published is shown by the following table:

Designation of ruling	Issued	Published	Percentage published, approximate
Advisory tax board recommendations (T. B. R.)	71	50	71
Committee on appeals and review memoranda (A. R. M.)	220	99	45
Committee on appeals and review recommendations (A. R. R.)	8,367	403	4
Office decisions (I. T.)	2,225	982	44
Office decisions (O. D.)	1,149	1,070	93
Solicitor's law opinions (O. or L. O.)	1,121	128	11
Solicitor's memoranda (S. M.)	3,413	251	7
Solicitor's opinions (Sol. Op.)	160	76	41
Solicitor's recommendations (S. R.)	3,137	46	2
Sales tax (S. T.)	448	57	12
Total	20,311	3,168	15½

The representatives of the commissioner stated to this committee that all rulings upon novel questions of general application were published, provided it were possible to so delete the facts as to destroy the identity of the case, and that unpublished rulings are never used as precedents. This statement is not sustained by the facts as disclosed by the investigation.

In that section of this report dealing with "Depletion and the valuation of natural resources" many formal rulings by the solicitor and the committee on appeals and review are reviewed and discussed. Every one of these rulings are of general interest and importance. The facts in every case could be so deleted as to destroy the identity of the taxpayer. Not one of these rulings have been published.

The following statement of several of these rulings suffices to prove their general importance and the fact that they can be stated without revealing the identity of the taxpayer:

A ruling by the solicitor that the commissioner may reconsider tentative valuation made for depletion purposes.

Rulings by both the committee on appeals and review and the solicitor that discovery depletion may be based upon discoveries made after the existence of the mineral is known.

A ruling that the provision barring discovery depletion when the property is acquired as the result of purchase of a proven tract or lease permits the allowance of discovery depletion to the owner of a fee which was a proven tract or lease when he acquired the fee, provided he had an option to purchase when the mineral was discovered.

In the National Aniline & Chemical case a published ruling of the solicitor was violated, and an unpublished ruling, advisory tax board recommendation No. 68, was followed. That this was not an oversight but was done deliberately is shown by the record.

In the United Motors Corporation case (3923), committee on appeals and review recommendation No. 6617 is contrary to published recommendation No. 34 providing for the 1913 valuation of corporate stock, yet No. 6617 was not published.

Recommendation No. 6617 is based upon seven unpublished rulings, one of which is L. O. 1117, which the committee states in its ruling was cited by both the unit and by the taxpayer. This particular ruling not only shows the extent to which unpublished rulings were relied upon as precedents, but discloses the fact that at least this taxpayer had access to and was able to avail itself of this unpublished precedent.

It may be observed that since June 1, 1925, the commissioner has refused to give this committee copies of unpublished rulings, some of which had been requested but the copying of which had not been finished on June 1, 1925. It thus appears that some taxpayers are permitted to secure and utilize rulings which even a Senate committee can not secure.

UNWRITTEN RULES AND PRACTICES

Many rules and formula for the determination of tax liability followed by the unit have never been even reduced to writing, except in the particular cases to which they were applied. Formal rulings are made only in response to taxpayers' inquiries upon taxpayers' appeals, and when requested from the solicitor. Where the taxpayer makes no such inquiry and is satisfied with the unit's determination of his tax there is no occasion for a ruling. The rules and formula applied in such case can only be ascertained by digging such cases out of the files. As there is no record or index of cases showing the questions involved the location of cases to ascertain how any particular question has been determined is entirely dependent upon the personal recollection of the employees of the unit.

The most notable illustration of this situation is found in the method of treating amortization allowances. The law merely provides that the taxpayer is entitled to a reasonable allowance. The regulations (Reg. 62, art. 184) provide how such allowance shall be determined in the case of property sold or discarded. In the case of property wholly or partially retained in use the regulations merely provide that the allowance shall be the difference between the cost of the facilities and the "estimated value to the taxpayer in terms of its actual use or employment in his going business."

There is nothing in the regulation indicating what "value in terms of actual use" means or how it is to be determined. Prior to October, 1925, there was one published ruling by the solicitor dealing with this question. This ruling has never been followed in any case, not even in the case in which it was made. No appeals have ever been taken by taxpayers which would give rise to rulings upon this subject. The only written instructions or memoranda ever prepared for the guidance of the different engineers who have been charged with the duty of passing on allowances for the amortization of war facilities appear to never have been authorized or approved by any authority higher than a section chief and to have never been followed by anybody.

Notwithstanding the fact that taxes amounting to over a hundred million dollars were lost through improper amortization allowances, there is nothing to show that the Commissioner of Internal Revenue had ever had his attention called to one amortization case or ever gave this great subject one moment's consideration until attention was called to it by the Senate investigating committee. It was also impossible for this committee or anyone else to ascertain how this subject was treated by the bureau, except by examining the record in each particular case.

The generally recognized published precedent on the valuation of good will provides for the capitalization of prospective profits at 20 per cent, while in some cases good will has been valued on a 6 per cent basis. These rates are as important as precedents as the formula to which they are applied.

THE TAX EXPERT

This system had not only led to the lack of uniformity and lack of consistency in rulings upon the same and closely related questions but has given rise to and now maintains the lucrative business of the tax expert or "fixer." There is nothing so involved, complicated, or technical about the procedure in the Income Tax Unit that anyone of ordinary intelligence can not understand it, provided he has access to the information. Taxpayers generally, however, to secure the advantages accorded others similarly situated find it necessary to employ some one with "inside" information.

To illustrate this situation, let us again resort to the subject of amortization.

A solicitor's ruling published in November, 1924, held that the value in use of facilities, upon which amortization is claimed, is to be determined by the actual use or usefulness of that particular facility in the taxpayer's post-war business. Until October, 1925, this was the only published ruling on the subject, and no one not initiated in the secret methods of the department would ever dream that the unit would hold in the face of that opinion, as it has, that the usefulness of a new, modern facility which is the last word in efficient, economical operation, and which is in constant daily operation, would be reduced because the taxpayer also possessed other facilities which had about reached the end of their useful lives and the actual use of which had been abandoned because they could not be economically operated.

Taxpayers found that by employing "experts" with inside information they could secure the allowance of deductions in amounts vastly in excess of the claims made in their original returns, upon a basis specifically condemned by the only published ruling upon the subject. The "expert" with "inside" information knew that such allowances had been made in other cases and could urge such cases as precedents to be applied to his own case.

Amortization is not the only subject with reference to which this situation exists. It is generally true throughout the Income Tax Unit.

This system has created, as a favored class of taxpayers, those who have employed "tax experts." It has created a special class of tax practitioners, whose sole stock in trade is a knowledge of the secret methods and practices of the Income Tax Unit.

This special knowledge of secret precedents has created a demand by large taxpayers for the services of Income Tax Unit employees, and is the principal cause of the immense turnover in the personnel of the unit.

PRACTICE AND PROCEDURE SHOULD BE WRITTEN AND PUBLISHED

No taxpayer should receive the benefit of special treatment which is not to be given all other taxpayers similarly situated. It therefore follows that every ruling, practice, and formula which has been followed in any case should be a precedent whether published or unpublished or whether written or unwritten.

Our system of legal and equitable jurisprudence are both the result of the accumulated precedent, arising out of the decisions of courts, in the application of law and equity to particular cases. This body of law is evidenced by, and is preserved in, the written decisions of the courts. When the courts give to a statute a construction which is contrary to the public will, the Congress or the State legislature are advised by the publicity given the decision of the construction so given it by the courts and can amend it. Anyone desiring to know how a statute has been construed by the courts has but to look to the published decisions, which are open to everyone. *A system of jurisprudence which provided for the secret trial of cases without published decisions and guided by no published rules would not be tolerated by any free, self-governing people.*

All practices and formula being followed in the work of the Income Tax Unit should be reduced to writing, at least tentatively approved by the Commissioner of Internal Revenue, and published. There can be no such thing as uniformity of treatment among taxpayers similarly situated unless there are written rules for the government of the employees of the unit.

The commissioner should be subject to the same responsibility for the practice of the bureau in cases where taxpayers are satisfied and there are no "rulings" as in cases where the appeals of dissatisfied taxpayers result in "rulings." Under the present practice it is doubtful whether the commissioner, in whom all authority under the act is vested, has the least idea how the law is being construed and applied in the case of satisfied taxpayers. It is certain that, under the present procedure, there is no provision for bringing the principles applied to such cases to the commissioner's attention.

Every taxpayer also has the same right to know the standard applied to other taxpayers in cases where there are no appeals as in cases where there are appeals. Congress should be as interested in knowing how the law has been construed and applied in the cases of subjects which have been so uniformly handled to the taxpayer's satisfaction that no appeals resulting in published "rulings" have been taken.

The methods followed by the bureau in handling amortization cases indicate that when the entire body of taxpayers are so well satisfied that no appeals are taken the Government is most liable to suffer.

At least the maximum and minimum discount rates and means of determining basic prices to be applied in different industries in making valuations on the basis of anticipated profits and the rate at which anticipated profits may be capitalized to determine value, as well as maximum depreciation rates, should be approved by the commissioner and published. From time to time the rates actually applied in such cases should also be published.

It is the purpose of this recommendation to place the actual responsibility for the work of the Income Tax Unit upon the Commissioner of Internal Revenue, where the legal responsibility rests, and as far as possible to insure the application of the same principles to similar cases.

The discretion of every employee of the unit should be limited by rules which can be uniformly applied to all taxpayers whose cases present similar questions. This can be accomplished by two classes of rules.

Tentative rules should be worked out by the engineering, auditing, and legal authorities as new questions are presented. Such tentatitve rules should be submitted to and approved by the commissioner and published. When such rules have been applied to particular cases they may be accepted by the taxpayers without protest. If a taxpayer protests he has a hearing, and as a result of such hearing it may appear that such rule should be amended, modified, or supplemented. Such amendment, modification, or supplemental rule should be proposed to the commissioner, and if approved by him applied to that case, promulgated, and published.

All existing opinions, rulings, recommendations, and memoranda of the solicitor, of the tax advisory board, and of the committee on appeals and review should be either approved or disapproved by the commissioner. All rulings, etc., so approved by the commissioner should be published. If disapproved, the cases in which such rulings were made should be reconsidered, unless such reconsideration is barred by the statute of limitations or the cases are closed under statutory agreement. All rulings of the rules and regulations section approved by the solicitor and not fully covered by published rulings should be published.

The test of novelty should not be applied to solicitors and committee on appeals and review rulings. The weight to be given a ruling is increased by the fact that such ruling has been subsequently affirmed. The arguments that in some cases the facts can not be sufficiently deleted to permit their publication and that other rulings are not of sufficient general interest to warrant publication are both clearly untenable. The omission of the taxpayer's name, address, and the amounts involved is clearly sufficient deletion of facts to satisfy the law, and if there is any doubt of this the law should be amended. The idea that some taxpayers are so peculiarly situated that no other taxpayer's case can present a similar question is an assumption too violent to be given serious consideration.

It is true that the plan proposed would increase the expense of publication. This increase will be saved many times in the reduced cost of auditing returns. Most taxpayers try to make their returns conform to the bureau's requirements, but the regulations and instructions are so vague that insufficient information and improperly prepared claims lead to endless correspondence and work for bureau employees.

It is now necessary for taxpayers to subscribe for privately published "tax services," and even employees of the bureau who desire to keep themselves informed are compelled to resort to such sources of information at an annual cost of from $50 to $60.

The proper publication of the bureau rules and procedure will dispense with the necessity for employing the tax fixer. His only stock in trade is a knowledge of the secret methods and practices, and when these become public property his services will no longer be of value.

Full publicity of rulings will reduce the number of protests, conferences, and appeals which now prevent the work of the unit from becoming current.

Actions are seldom brought in the courts involving questions of law which have been clearly settled by former decisions. Frequently the decision of one case will lead to the dismissal or settlement of many. This is due to the fact that every decision of a court of last resort is a precedent to be followed whenever the same question is presented in another case, and through the publication of such decisions the public is enabled to learn what these precedents are. But a few litigious people are willing to waste time and money in a vain attempt to secure a reversal of the rulings of the courts.

It is reasonable to assume that the principles involved in the vast majority of the cases now pending before the unit have been passed upon at least once and in some instances many times in the 20,311 rulings which have been made. Had these rulings been published, and had the unit announced and adhered to the policy of regarding them as precedents to be followed in future cases unless shown to be clearly wrong, there would be fewer contests now consuming the time and money of both the taxpayers and the unit.

It is doubtless true that such publicity would lead to the filing of many claims by taxpayers who have not received as favorable treatment as has been given others. This is no argument against full publicity of rulings, unless we concede that the tenacious, resourceful taxpayer whose claims are sufficiently large to warrant the expense of trips to Washington and the employment of "experts" should constitute a favored class.

Many cases have been presented to the committee showing allowances which the representatives of the unit could defend only upon the ground that such allowances were determined as the result of bargaining or compromise with the taxpayer. It was stated in nearly every such instance that the improper allowance was made because the taxpayer waived some other claim which he might have asserted. In none of these cases did the nature of the claim which was waived appear in the record so that it could be judged upon its own merits.

In the United Verde Extension Mining Co. case the taxpayer was allowed $2,000,000 depletion which Deputy Commissioner Bright made no attempt to defend. He tried to justify his refusal to permit the reopening of that case upon the ground that the company had waived some claim. Mr. Bright admitted that he did not and never had known the nature of the claim waived.

Mr. S. M. Greenidge, head of the engineering division, admitted that the silver industry had been undertaxed, but attempted to justify the failure to reopen the silver cases upon the ground that to do so would result in the reopening of the case of the lead industry which had been overtaxed.

Mr. Greenidge tried to justify the allowance of excessive depletion to the Gulf Oil Corporation upon the ground that the taxpayer had waived an unsubstantiated claim for amortization the nature of which he did not know.

The law contemplates taxation by assessment by the Government, not by bargain between the Government and the taxpayer. Taxation by bargain and compromise means the lowest tax to the best trader. The policy of bargaining with taxpayers leads to the setting up of fictitious claims as trading stock to be waived during the course of bargaining. This not only results in unequal taxation but vastly increases the work of the Income Tax Unit by throwing upon it the burden of meeting fictitious claims.

The number of cases three, four, and five years old pending in the unit has increased during the last two years. This is due to the constant filing of new claims affecting the tax of former years and the reconsideration of old allowances. The policy of bargaining is doubtless largely responsible for this situation.

If each claim were considered and determined upon its own merit and such determination were published as a precedent, this bargaining would stop. The officers of the unit in passing on claims would know that an allowance made to one taxpayer would be claimed by all taxpayers similarly situated, and this fact alone would be the best possible deterrent from making improper allowances.

It seems plain that proper publicity of methods and practices is not only essential to maintain uniformity in the bureau itself and to properly inform the Congress and the public of how the law is interpreted and applied but that it will result in a saving to the Government and to the taxpayers of many times what it will cost.

PUBLICITY OF RECORDS

The unsatisfactory conditions developed by this investigation are the inevitable result of the delegation of almost unlimited discretion to be secretly exercised. It is believed that but few of the unsound settlements, to which attention has been called, would have been made if it were not for the belief that they would never become public.

While the objections to throwing the records of the Income Tax Unit open to the public are recognized, the necessity for the opportunity for some outside scrutiny is imperative.

Congress, in imposing a system of taxation the administration of which necessarily involves the exercise of so much discretion, assumes some duty to the public to see that such discretion is not abused.

It is suggested that the law should provide that any Member of Congress or Senator shall have the right to examine any return or record at any time and take a copy thereof.

To insure the full publicity of the rulings, practices, methods, and formulas in use in the determination of tax, it is suggested that the law provide that no settlement of any tax be considered final unless the principles applied in determining such tax shall have been published within 30 days after such determination.

PROGRESS OF INCOME TAX UNIT IN GETTING WORK CURRENT

On March 1, 1925, the Income Tax Unit was 30.4 per cent further behind than it was on March 1, 1923, and 34.4 per cent further behind than it was on March 1, 1924. Unless there are some radical reforms in procedure there is no prospect of the work of the Income Tax Unit ever becoming current.

The unit may receive and dispose of an increasing number of cases during each succeeding year and still be getting further behind if the old cases are accumulating. In analyzing the work of the Income Tax Unit we have treated all cases less than three years old as current cases. The following table is a summary of the open cases in the unit which are over three years old:

Summary of open returns on hand, classified by age

	Returns five years old or older			Returns four years old			Returns three years old		
	March, 1923	March, 1924	March, 1925	March, 1923	March, 1924	March, 1925	March, 1923	March, 1924	March, 1925
Personal audit division	9,450	10,144	8,197	20,105	18,639	16,784	35,975	27,707	10,675
Corporation audit division	5,288	9,098	6,064	24,807	24,745	10,365	35,364	41,874	12,916
Consolidated returns audit division	2,254	4,088	4,806	5,532	5,249	9,684	5,347	7,095	12,112
Special assessment section	2,229	3,015	8,390	3,958	2,144	3,927	3,787	2,806	1,111
Special adjustment section	333	534	701	968	587	433	1,063	560	357
Engineering division	637	1,215	1,955	4,201	2,836	1,913	5,574	4,250	2,015
Records division	2,043	1,482	1,556	24,263	2,952	65,976	46,651	9,573	206,166
Total	22,234	29,576	31,669	83,834	57,152	109,082	133,761	93,955	254,352
In field	11,194	574	(1)	28,830	36,118	(1)	23,144	76,667	(1)
Grand total	33,428	30,150	31,669	112,664	93,270	109,082	156,905	170,622	254,352

[1] Included in records division.

Total returns 3 years old or older on hand as of March, 1923	302,997
Total returns 3 years old or older on hand as of March, 1924	294,042
Total returns 3 years old or older on hand as of March, 1925	395,103
Total per cent gain in getting current, 1923 to 1924	2.6
Total per cent loss in getting current, 1924 to 1925	34.4
Total per cent loss in getting current two years, 1923 to 1925	30.4

Causes of Delay in Disposal of Cases

This investigation discloses that the principal causes of the delay in the disposal of old cases may be stated as follows:

1. Bargaining with taxpayers instead of assessing taxes in accordance with published precedents. This subject has already been fully discussed.
2. Innumerable conferences incident to the bargaining policy.
3. Granting innumerable extensions of time for furnishing information required to determine the validity of deductions.

HEARINGS AND CONFERENCES

The law requires that a taxpayer be given notice and an opportunity to be heard before a deficiency tax is assessed. One hearing should suffice, and were the tax then assessed in accordance with published precedents the accumulated cases would be quickly disposed of. The policy in the larger cases appears to call for an agreement with the taxpayer, and conferences are held until such agreement is reached.

EXTENDING TIME TO FURNISH INFORMATION

In many instances large deductions for amortization, depletion, loss on sales, etc., are taken without furnishing such information as may be required to check the validity of such deductions. In many other cases such information is withheld until the case has passed out of the hands of the auditor or engineer who has worked on the case and is familiar with it.

When information is called for, a definite time should be set within which it may be furnished. If such information is not furnished within the time set, the deductions claimed should be disallowed, and the law should provide that no taxpayer should be permitted to avail himself, before the Board of Tax Appeals or in court, of any evidence called for but not furnished to the Income Tax Unit.

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INVESTIGATION OF THE BUREAU OF INTERNAL REVENUE

February 1 (calendar day, February 2), 1926.—Ordered to be printed with illustrations

Mr. Couzens, from the Select Committee on Investigation of the Bureau of Internal Revenue, submitted the following

REPORT

[Pursuant to S. Res. 168, 68th Cong.]

The statistics prepared and published by the Bureau of Internal Revenue, with reference to the income of individuals and corporations, do not adequately reflect the effect of the various provisions of the law.

The sources of individual income are shown. All deductions from individual income, except contributions, are combined under the heading "General deductions." The inadequacy of the information as to deductions is illustrated by the situation relative to the tax upon the profit realized upon the sale of capital assets and the de[illegible]tion of losses sustained upon such sales.

The published statistics for 1923 show a large amount of in[illegible] taxed in the brackets over $100,000 from this source. Our inv[illegible]tion discloses the fact that the deductions taken for losses sustained on the sale of capital assets by taxpayers whose incomes would fall in the high brackets, but for such deductions, exceeded the profits taxed in 1923 in the high brackets. Our investigation further discloses that such deductions exceed the profits taxed for every year since 1916, except 1924.

These facts show the necessity for a thorough investigation of the subject of taxing capital gains. Such facts should be shown by the statistics of income published by the Bureau of Internal Revenue.

A finance committee amendment to the pending revenue bill fixes the depletion allowance for oil and gas wells at 25 per cent of the gross income, but not to exceed 50 per cent of the net income derived from the property. It is important to know whether this provision increases or decreases the depletion which has been allowed under existing law. A similar allowance of a per cent of gross or net income for the depletion of mines has been suggested. If the published statistics showed the amount of depletion which has been deducted by the different mining industries, the basis for the determination of a proper percentage would be available.

The net taxable income of both individuals and corporations is affected as materially by deductions as by fluctuations in the income derived from various sources, yet the published statistics provide practically no information as to these deductions.

Section 258 of the bill should be so amended as to require the segregation of deductions into such classes as will reflect the effect of each deduction permitted by the law upon the net income taxed.

INDIVIDUAL INCOMES $100,000 AND OVER, 1916 TO 1924

The net taxable incomes reported by individuals with incomes from $5,000 to $100,000 have increased from $3,817,720,895 in 1916 to $8,356,429,153 in 1924, about 119 per cent. The net taxable incomes of $100,000 and over have decreased from $1,856,187,710 in 1916 to $1,223,312,274 in 1924, or about 50 per cent.

The number of returns, total income, deductions, and net income reported by these two groups of taxpayers are shown in the following tables:

Individual returns, $5,000 to $100,000

Year	Number of returns	Total income	Deductions and contributions	Net income
1916	265,619	$5,204,791,131	$1,387,070,236	$3,817,720,895
1917	425,998	5,759,335,727	355,447,602	5,403,888,125
1918	474,463	6,483,359,295	943,357,782	5,540,001,513
1919	652,133	8,869,634,803	1,329,359,949	7,540,274,854
1920	677,913	9,409,538,245	1,675,131,050	7,734,407,195
1921	523,254	7,288,817,802	1,390,042,836	5,898,774,966
1922	582,175	8,185,251,153	1,317,284,844	6,867,966,309
1923	617,779	8,859,482,324	1,420,137,484	7,439,344,840
1924	675,893	9,659,812,025	1,303,382,872	8,356,429,153

Individual returns, $100,000 and over

Year	Number of returns	Total income	Deductions and contributions	Net income
1916	6,633	$2,188,881,355	$332,693,645	$1,856,187,710
1917	6,664	1,709,366,038	102,849,885	1,606,516,153
1918	4,499	1,188,884,175	198,644,750	990,239,425
1919	5,526	1,438,775,854	269,222,806	1,169,553,048
1920	3,649	966,023,223	239,018,460	727,004,763
1921	2,352	625,817,112	162,813,761	463,003,351
1922	4,031	1,092,401,065	199,653,385	892,747,680
1923	4,182	1,127,273,807	214,285,298	912,988,509
1924	5,694	1,440,092,393	216,780,119	1,223,312,274

The causes of the rise and fall of individual taxable income, particularly in the higher tax brackets, has been the subject of much discussion during the last five years. There has been little, if any, real information available, and the whole discussion has been based upon assumptions. This committee has undertaken to ascertain the facts, as to what has caused the shrinkage and wide fluctuation in individual taxable incomes exceeding $100,000 since 1916.

OFFICIAL STATISTICS

Statistics showing the incomes reported by individuals and corporations, the exemptions and deductions taken, the net income taxed and the amount of tax on incomes as reported are published by the Bureau of Internal Revenue in an annual publication entitled "Statistics of Income."

These published statistics show the aggregate incomes reported classified by tax brackets. The different sources of individual income are shown, but there is no classification of deductions. It is therefore impossible to determine from the official statistics how different classes of deductions have affected net taxable income.

The statistical methods employed in preparing and presenting the official published statistics are such that it is impossible to determine to what extent the total income in any particular bracket has been influenced by income derived from any particular source. Thus, A has a net income in 1923 of $95,000, all of which is derived from dividends. In 1924 A's dividends are only $90,000 above his exemptions, but he disposes of some stock at a profit of $10,000. The $10,000 profits, derived from the sale of stock, bring A's income into the $100,000 class, and A's dividends add $90,000 to the dividends appearing in that class. Thus, while A's dividends actually decreased $5,000, the dividends classified as received in the $100,000 class are increased by $90,000.

COMMITTEE'S STATISTICS OF INDIVIDUAL INCOMES EXCEEDING $100,000 IN 1916

To obtain comparable statistics this committee called for the returns for the years 1916 to 1924, inclusive, of all individuals who reported net taxable incomes exceeding $100,000 in 1916. Net taxable incomes exceeding $100,000 were reported by 6,633 individuals in 1916. It was possible to obtain the returns for all years, 1916 to 1924, inclusive, for 4,063, or nearly two-thirds of the entire number. Both the income by sources (taxable and tax exempt) and the deductions taken by these 4,063 individuals have been tabulated, and the results are shown in Tables 1 to 7, attached.

SHRINKAGE AND VARIATION IN INCOMES EXCEEDING $100,000

In 1916 this group reported net taxable incomes of $1,178,113,103. The same individuals reported net taxable incomes of $355,482,519 in 1921 and $586,353,450 in 1924. A summary for the entire group, showing the income from each source (taxable and tax exempt) and deductions and deductible losses is shown in Table 1.

The rise and fall of income and deductions in the group are shown graphically by the charts hereto attached.

An examination of Table 1 will show that the difference of $822,630,584 between the net taxable income reported by this group in 1916 and in 1921 is accounted for as follows:

Income from individual business and partnerships in 1916 exceeded such income in 1921 by $314,189,761. Losses in individual business and partnerships in 1921 exceeded such losses in 1916 by $22,051,914. Net difference (decrease in 1921)	$336, 241, 675

Profits on the sale of stock, bonds, and real estate in 1916 exceeded such profits in 1921 by $47,817,455. Losses on the sale of stocks, bonds, and real estate in 1921 exceeded such losses in 1916 by $158,164,394. Net difference (decrease in 1921)		$205, 981, 849
Dividends on stock of domestic corporations in 1916 exceeded such dividends in 1921 by		210, 948, 185
Interest received reported as income in 1916 exceeded interest received in 1921 by $22,479,670. Interest paid and deducted from income in 1921 exceeded interest deducted in 1916 by $20,705,393. Net difference		43, 185, 063
Rents and royalties reported as income in 1916 exceeded such income in 1921 by		11, 067, 304
Miscellaneous income in 1916 exceeded miscellaneous income in 1921 by $7,291,454, and miscellaneous losses in 1921 exceeded such losses in 1916 by $5,745,473. Net difference		13, 036, 927
Contributions, taxes, and bad debts deducted in 1921 exceeded such deductions in 1916 by		21, 434, 311
		841, 885, 314
In some cases the losses exceeded the income, and such excess of losses over income could not be deducted from the income of 1921, but were carried forward to subsequent years:		
Excess of losses over income	$10, 685, 846	
Salaries reported as income in 1921 exceeded such income in 1916 by	8, 568, 884	
		19, 254, 730
Decrease in net taxable income 1916 to 1921		822, 630, 584

The net taxable incomes of this group of 4,063 taxpayers increased from $355,482,519 in 1921 to $586,353,450 in 1924. The difference of $230,870,931 is shown by Table 1 to be due to the following items:

Income from individual and partnership business in 1924 exceeded such income in 1921 by $11,452,032 and losses in individual and partnership business in 1921 exceeded such losses in 1924 by $11,559,392; net difference	$23, 011, 424
Profits on the sale of real estate, stock, and bonds in 1924 exceeded such profits in 1921 by $90,493,395 and the losses on the sale of such capital assets in 1921 exceeded such losses in 1924 by $106,-336,982; net difference	196, 830, 377
Dividends in 1924 exceeded such income in 1921 by	64, 552, 084
Rents and royalties in 1924 exceeded such income in 1921 by	89, 085
	284, 482, 970
Salaries in 1921 exceeded such income in 1924 by	2, 752, 458
No prior year losses were deducted in 1921. This deduction in 1924 was	7, 213, 474
Miscellaneous income in 1924 exceeded such income in 1921 by $654,875, but miscellaneous losses in 1924 exceeded such losses in 1921 by $6,718,887, leaving a net decrease of	6, 064, 012
Interest received, reported as income in 1921, exceeded such income in 1924 by $18,431,597 and interest paid in 1921 exceeded interest paid in 1924 by $8,594,427; net difference	9, 837, 170
Contributions in 1924 exceeded contributions in 1921 by	25, 313, 545
The excess of losses over income not deducted in 1921 exceeded such excess in 1924 by	2, 431, 380
	53, 612, 039
Increases in net taxable income, 1921 to 1924	230, 670, 931

It thus appears that of the decline in net taxable incomes in this group from 1916 to 1921, about 41 per cent was due to decrease in business and partnership profits and increase in business and partnership losses. About 25 per cent of such decline was due to the decline in profits arising out of the sale of capital assets and to the increase in losses upon such sales, and about 25 per cent of the decline was due to a decline in dividends reported as income. The variation in these three items accounts for more than 91 per cent of the difference between the net taxable incomes reported by this group in 1916 and 1921.

Increased profits and decreased losses reported from the sale of capital assets amount to 85 per cent of the difference between the net taxable incomes in this group in 1921 and 1924, and increased dividends amount to 28 per cent of the increase in net income during that period. The increase in business and partnership profits in 1924 over 1921 equals 10 per cent of the increase in net taxable income.

It is manifest that profits and losses in individual and partnership business, profits and losses which arise from the sale of capital assets, and dividends are the principal factors determining net taxable incomes exceeding $100,000.

TAX-EXEMPT INCOME

The tax-exempt income of this group of 4,063 individuals in the years 1918, 1919, 1920, and 1924 was shown by the returns, and is shown in Table 1 for those years. For the years 1916, 1917, 1921, 1922, and 1923 such information was not available. The total income from taxable and nontaxable sources, the tax-exempt income, and the per cent of total income (taxable and nontaxable) which is tax exempt are shown by the following table for the years 1918, 1919, 1920, and 1924:

Year	Total income, including tax-exempt income	Tax-exempt incomes	Per cent of total income exempt
1918	$890,475,002	$25,001,111	2.8
1919	962,301,032	42,962,988	4.5
1920	872,492,041	51,350,315	5.9
1924	888,466,833	69,230,303	7.8

The net taxable income of this group in 1924 was $591,759,653 less than in 1916. The tax exempt income of this group in 1924 is $69,230,303, or less than 12 per cent of the difference between the 1916 and the 1924 net taxable income of the group.

In this group there are 121 individuals who reported net taxable incomes of $1,000,000 and over in 1916. This is 60 per cent of the individuals reporting net taxable income exceeding $1,000,000 in 1916. The incomes and deductions reported by these 121 individuals, for each year 1916 to 1924, inclusive, are shown in Table 2.

It will be noted that these 121 individuals reported net taxable income of $307,359,746 in 1916, $61,271,702 in 1920 and $101,934,020 in 1924. The net incomes reported by these individuals in 1920 was $246,088,044 less than the net income reported in 1916. In 1920 these individuals reported tax exempt incomes amounting to $12,336,200. Assuming that these individuals had no tax exempt income in 1916, their tax exempt income in 1920 would account for only 5 per cent of the shrinkage in their taxable incomes between 1916 and 1920.

The taxable income of this subgroup increased $40,662,318 from 1920 to 1924 and their tax-exempt income increased $3,742,404 between those years.

The taxable net income of this group was $205,425,726 greater in 1916 than in 1924, yet the tax exempt income of the subgroup in 1924 was only $16,078,604, or less than 8 per cent of the shrinkage in net taxable income.

It is thus evident that tax-exempt income is a negligible factor in causing the shrinkage in net taxable incomes of $100,000 and over, and is even a smaller factor in the shrinkage of incomes exceeding $1,000,000 than in those between $100,000 and $1,000,000.

DIVIDENDS

The dividends reported as income by this group during the period 1916 to 1924, inclusive, average about 80 per cent of the investment income of the group. The decrease in dividends from 1916 to 1921 is equal to approximately 25 per cent of the decrease in net income during that period, and the increase in dividends from 1921 to 1924 is equal to about 28 per cent of the increase in net income during that period.

The following table shows the net income of corporations, the Federal tax paid by corporations, the net income less Federal tax of corporations, and the dividends reported by this group of 4,063 individuals who reported net income exceeding $100,000 in 1916:

Year	Net income of corporations	Federal tax on corporations	Net income of corporations less Federal taxes	Dividends reported as income by 4,063 individuals
1916	$8,765,908,984	$171,805,150	$8,594,103,834	$582,005,301
1917	10,730,360,211	2,142,445,769	8,587,914,442	579,111,365
1918	8,361,511,249	3,158,764,422	5,202,746,827	440,212,155
1919	9,411,418,458	2,175,341,578	7,236,076,880	436,426,749
1920	7,902,654,813	1,625,234,643	6,277,420,170	448,576,224
1921	4,336,047,813	701,575,432	3,634,472,381	371,057,116
1922	6,963,811,143	783,776,268	6,180,034,875	389,360,816
1923	8,321,529,134	937,106,798	7,384,422,336	424,742,904

It will be noted that the net income of corporations, after paying Federal taxes for 1916 and 1917, were approximately the same, and that the dividends reported by this group of individuals are approximately the same for those years. In 1918 price fixing and Federal taxes reduced the net earnings of corporations after tax by about 40 per cent, and this reduction in earnings available for dividends is reflected in a reduction of about 24 per cent in the dividends reported by this group of individuals.

In comparing these figures the fact must be kept in mind that, while earnings available for dividends control the dividend policy of corporations, dividends do not fluctuate with net earnings available for dividends.

Except for the decline in dividends reported by this group in 1921 and 1922, which is a reflection of the marked decline in earnings in 1921, the dividends reported during the period 1918 to 1924, inclusive, are fairly constant. The slight decline during this period is no more than can be accounted for by the policy of closely controlling corporations to accumulate earnings. These figure., do not indicate any tendency by individuals in this group to change their investments from dividend paying corporate stock to tax-exempt securities.

All of the schedules in this group were examined for the purpose of finding cases where taxable income had been entirely or largely replaced by tax-exempt income. One such case was located out of 4,063 taxpayers.

BUSINESS AND PARTNERSHIP PROFITS AND LOSSES

As has been shown, about 41 per cent of the decline in net income from 1916 to 1921, and about 10 per cent of the increase in net income from 1921 to 1924, in this group, is attributable to the difference in the profits and losses in individual and partnership business.

Individual business and partnership losses reported each year from 1916 to 1921, inclusive, are shown in the following table:

Business and partnership profits and losses reported by 4,063 individuals who reported net incomes of $100,000 and over in 1916

Year	Profits	Losses	Differ..ce
1916	$405,603,434	$5,764,380	$399,839,054
1917	170,478,801	6,904,439	163,574,362
1918	173,445,142	6,177,221	167,367,921
1919	202,634,003	11,473,255	191,160,748
1920	129,222,678	25,202,628	104,020,050
1921	91,413,673	27,816,294	63,597,379
1922	121,054,622	17,892,691	103,161,931
1923	91,082,193	18,898,359	72,183,834
1924	102,865,705	16,256,902	86,608,803

The taxpayers in the group examined, who reported large incomes and losses from business and partnerships, were principally dealers in stocks, bonds, and real estate, participants in underwriting syndicates, and professional men. The principal source of income in this class is represented by the profits of dealers in stocks and bonds and underwriters of issues of stocks and bonds.

The profits derived from the flotation of tremendous issues of foreign bonds and the sale of supplies to foreign nations in 1916 are reflected in the figures for that year.

A large part of the shrinkage of income from this source since 1919 is due to the incorporation of partnerships and the failure of such corporations to distribute the earnings available for dividends. Prior to 1918 most dealers in stocks, bonds, and real estate were not incorporated. The incorporation of many such businesses in 1918 and subsequent years has been a most important factor in the decline of individual income in the high-tax brackets from this source.

PROFITS AND LOSSES ON THE SALE OF REAL ESTATE, STOCKS, AND BONDS

Attention has been called to the fact that the decrease in net income, due to the decline in profits from the sale of real estate, stocks, bonds, etc., reported as income, and to the increase in losses deducted, equals approximately 25 per cent of the decline in the net income of this group from 1916 to 1921, and that the increase in such profits and the decrease in losses is equal to 85 per cent of the increase in net income from 1921 to 1924, inclusive.

The profits reported as income and the losses taken as deductions are shown by the following tables:

Profits and losses on sale of capital assets, 1916 to 1924, reported by 4,063 individuals who reported net taxable incomes of $100,000 or over in 1916

Year	Profits on sale of capital assets	Losses on sale of capital assets	Excess of profits over losses	Excess of losses over profits
1916	$58,413,671	$1,957,038	$56,456,633	
1917	28,836,826	19,150,961	9,685,865	
1918	7,937,991	65,072,240		$57,134,249
1919	36,687,447	124,253,174		87,565,727
1920	10,910,541	216,116,946		205,206,405
1921	10,596,216	100,121,432		149,525,216
1922	95,245,775	87,032,461	8,213,314	
1923	78,345,775	101,958,153		23,612,378
1924	101,089,611	53,784,450	47,305,161	
	428,053,850	829,446,855		
		428,053,850		
Excess of losses deducted over profits taxed		401,393,005		

Profits and losses on sale of capital assets, 1916 to 1924, reported by 121 individuals who reported net taxable incomes of $1,000,000 and over in 1916

Year	Profits on sale of capital assets	Losses on sale of capital assets	Excess of profits over losses	Excess of losses over profits
1916	$20,054,889	$108,010	$19,946,879	
1917	4,025,418	7,250,083		$3,224,665
1918	847,557	19,629,131		18,781,574
1919	5,886,396	31,784,615		25,898,219
1920	2,060,025	48,771,542		46,711,517
1921	1,633,604	35,409,707		33,776,103
1922	11,944,551	28,111,381		16,166,810
1923	10,888,283	27,906,807		17,018,524
1924	19,642,732	14,154,685	5,488,047	
Total	76,983,455	213,125,941		
		76,983,455		
Excess of losses deducted over profits taxes		136,142,486		

An examination of 400 cases showed the nature of the transactions out of which such profits and losses arose to be as follows:

	Per cent of profits	Per cent of losses
Sales of stock	89.17	70.66
Sales of bonds	4.92	20.62
Sales of real estate	5.91	3.59
Worthless stock and bonds		5.13
Total	100.00	100.00

The above figures show that the losses sustained upon the sale of capital assets, which have been deducted from income by this group, are about twice the taxable income from gains. The 121 individuals in this group who reported net incomes exceeding $1,000,000 in 1916 have deducted nearly three times as much losses as the gains taxed. When the losses are considered, the tax on capital gains has resulted in a tremendous loss of revenue to the Government. As but about 5 per cent of the losses are due to the charging off of worthless securities, the major portion of these transactions are cases in which stock has been sold and the proceeds reinvested.

The entire stock market was on the decline from the fall of 1919 to about July 1, 1921. Almost any stock acquired in 1917 or 1918 could be sold at a loss during this period of nearly two years. This loss could be deducted from the taxable income of 1919, 1920, or 1921. During all of 1922 up to about October 1 stocks were increasing in value, but industrial stocks generally did not reach the high point of 1919. Stocks generally declined in 1923, rose again in 1924, and passed the high point of 1919 in the latter part of 1925.

The large profits reported as income in 1924 are directly attributable to the rise in the stock market during that year, and a large amount of income from this source should be expected for 1925.

While 1924 and 1925 may show taxable gains largely exceeding losses deducted, the productivity of the tax upon capital gains coupled with the deduction of capital losses is more than doubtful.

In considering the tax on profits derived from the sale of capital assets, the fact must not be overlooked that this is the only means of reaching the profits realized upon the sale of stock dividends. If this class of income were not subject to tax, the use of stock dividends, as a means of distributing corporate earnings, would have a tendency to increase, and taxable cash dividends would be likely to decrease.

TABLE No. 1.—*Summary of returns for 1916 to 1924, inclusive, of 4,063 individuals who reported net taxable income $100,000 and over in 1916*

	1916	1917	1918	1919	1920	1921	1922	1923	1924
INCOME									
Salaries, wages, and commissions	$77,[illegible]	$108,097,190	$96,250,978	$99,596,582	$99,991,065	$86,545,561	$80,116,629	$85,721,889	$83,793,103
Business and partnership profits	40[illegible]	170,478,801	173,445,142	202,634,001	129,222,678	91,413,673	121,054,622	91,082,[illegible]	132,865,705
Profits on sale of capital assets	[illegible]	28,837,826	7,937,991	36,087,447	10,910,541	10,596,216	95,245,772	78,315,775	101,089,611
Miscellaneous income	[illegible]	4,188,944	4,064,176	6,410,351	4,766,697	2,934,485	3,505,[illegible]	[illegible],276,381	3,589,360
Cash dividends	[illegible]	779,111,365	440,212,155	436,426,749	418,576,224	371,077,116	389,560,816	429,742,984	455,609,200
Rents and royalties	[illegible]	22,118,932	19,916,997	21,150,888	20,817,483	22,926,457	23,708,871	23,208,[illegible]	25,015,542
Interest (taxable)	110,[illegible]	120,393,291	121,646,452	116,432,024	109,857,098	87,706,[illegible]	76,847,[illegible]	75,115,22[illegible]	[illegible],274,009
Total	1,278,[illegible]	1,633,225,358	865,473,891	919,338,044	821,141,726	673,179,114	789,859,864	784,548,081	[illegible],236,530
Excess of losses over income		2,720,014	92,662	3,448,142	5,475,966	16,685,846	6,887,430	9,631,634	8,254,466
Interest (tax exempt) [1]	[illegible]	(¹)	25,001,111	42,962,988	51,350,315	(¹)	(¹)	(¹)	[illegible],230,303
Total, including current year losses and tax-exempt interest		1,635,945,372	890,567,664	965,749,174	877,968,007	689,864,960	79[illegible],747,294	794,180,715	[illegible],721,296
DEDUCTIONS									
[illegible] losses				15,237	1,216,500		7,300,377	7,[illegible],486	7,213,474
Business and partnership losses	5,764,[illegible]	6,904,439	6,177,221	11,473,255	25,202,628	27,816,[illegible]	17,876,429	18,858,358	16,256,902
Losses from sale of capital assets	[illegible]	19,150,961	65,072,240	124,253,174	216,116,946	160,121,452	87,032,461	101,958,15[illegible]	73,784,450
Miscellaneous losses	[illegible]	8,132,393	12,782,096	13,202,972	11,658,107	11,082,989	11,081,074	12,945,445	17,501,876
Contributions, taxes, bad debts, and other deductions	[illegible],406,747	82,525,060	84,845,309	83,646,824	79,137,334	81,825,058	86,186,079	101,045,002	177,138,603
Interest paid	2[illegible],821,275	26,165,026	31,704,847	38,718,072	48,731,333	47,598,[illegible]	43,149,015	42,265,165	[illegible]8,942,241
Total	[illegible]	142,877,902	200,581,713	270,709,534	382,062,848	328,382,491	263,[illegible]	254,[illegible]	[illegible],137,546
Interest (tax exempt) [1]	[illegible]	(¹)	25,001,111	42,962,988	51,350,315	(¹)	(¹)	(¹)	[illegible],230,303
Total, including tax-exempt interest			225,582,824	313,672,522	433,413,163				[illegible]0,367,849
Net income	1,178,[illegible]	893,067,470	664,984,840	652,076,652	444,554,844	355,[illegible]	533,221,279	509,241,5[illegible]	[illegible],533,450

¹ TAX EXEMPT INCOME

	1918	1919	1920	1924
Obligations of the United States and its possessions	$8,763,[illegible]	$16,116,731	$19,422,496	$15,079,419
Obligations of States and Territories	12,779,968	16,656,519	22,172,238	43,827,034
Federal farm-loan bonds	723,265	1,348,910	2,102,72[illegible]	6,797,496
Tax-exempt interest on obligations of United States and War Finance Corporation not wholly tax exempt	2,743,720	8,840,828	7,651,848	3,556,354
Total wholly tax-exempt income	25,001,111	42,962,988	51,350,315	69,250,303

² Information not available

TABLE No. 2.—*Summary of returns for 1916 to 1924, inclusive, of 121 individuals who reported net taxable income of $1,000,000 and over in 1916*

	1916	1917	1918	1919	1920	1921	1922	1923	1924
INCOME									
Salaries, wages, and commissions	[illegible]	$7,229,584	$6,129,368	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Business and partnership profits	[illegible]	19,413,540	[illegible]	[illegible]	[illegible]	[illegible]	12,176,360	[illegible]	[illegible]
Profits on sale of capital assets	[illegible]	4,025,418	847,557	5,886,396	[illegible]	[illegible]	11,944,571	[illegible]	[illegible]
Miscellaneous income	[illegible]	215,750	476,506	1,109,183	[illegible]	431,749	626,277	[illegible]	271,481
Cash dividends	[illegible]	[illegible]	118,334,363	117,900,674	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Rents and royalties	[illegible]	3,972,789	4,747,113	5,204,571	5,274,045	[illegible]	[illegible]	[illegible]	[illegible]
Interest (taxable)	[illegible]	28,887,870	28,198,431	21,724,100	17,676,182	[illegible]	[illegible]	[illegible]	[illegible]
Total	[illegible]	227,732,476	172,101,690	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Excess of losses over income					186,242	[illegible]	[illegible]	74,228	51,781
Interest (tax exempt)[1]	(2)	(2)	6,011,297	10,239,784	[illegible]	(2)	(2)	(2)	[illegible]
Total, including current year losses and tax-exempt interest			178,112,987	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
DEDUCTIONS									
Prior year losses							[illegible]	47,796	
Business and partnership losses	[illegible]	810,430	596,002	712,727	1,647,370	2,133,457	1,919,047	[illegible]	2,249,069
Losses on sale of capital assets	[illegible]	7,250,083	19,629,151	31,784,615	48,771,542	35,409,707	[illegible]	[illegible]	[illegible]
Miscellaneous losses	[illegible]	1,385,255	2,071,316	2,411,424	1,096,389	2,636,057	789,204	[illegible]	[illegible]
Contributions, taxes, bad debts, and other deductions	[illegible]	24,664,782	28,160,156	22,656,645	[illegible]	19,346,541	[illegible]	[illegible]	[illegible]
Interest paid	[illegible]	5,658,687	6,928,375	7,869,705	11,344,773	[illegible]	10,025,820	[illegible]	7,791,030
Total	[illegible]	39,769,237	52,384,990	65,425,116	[illegible]	70,713,419	[illegible]	[illegible]	[illegible]
Interest (tax exempt)	(2)	(2)	6,011,297	10,239,784	[illegible]	(2)	(2)	(2)	[illegible]
Total including tax-exempt interest			58,396,277	75,674,900	93,254,498				[illegible]
Net income	[illegible]	187,963,239	119,716,710	107,917,923	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

[1] TAX-EXEMPT INCOME

	1918	1919	1920	1924
Obligations of the United States and its possessions	$2,806,560	[illegible]	[illegible]	$6,110,564
Obligations of States and Territories	2,823,554	3,610,800	[illegible]	[illegible]
Federal farm loan bonds	241,522	[illegible]	[illegible]	[illegible]
Tax-exempt interest on obligations of the United States and War Finance Corporation not wholly tax exempt	139,661	396,411	265,267	155,354
Total wholly tax-exempt interest	6,011,297	10,239,784	[illegible]	[illegible]

[2] Information not available.

TABLE No. 3.—*Summary of returns for 1916 to 1924, inclusive, of 257 individuals who reported net taxable income of $500,000 to $1,000,000 in 1916*

	1916	1917	1918	1919	1920	1921	1922	1923	1924
INCOME									
Salaries, wages, and commissions	$9,232,787	$11,906,222	$10,048,903	$10,676,347	$9,503,351	$8,889,449	$6,818,086	$7,076,595	$7,097,672
Business and partnership profits	64,268,282	23,137,873	18,949,414	20,399,752	15,070,474	10,342,510	14,671,877	9,559,634	11,220,092
Profits on sale of capital assets	10,401,299	4,796,416	967,332	2,989,447	1,453,640	651,747	11,835,979	22,230,505	11,382,316
Miscellaneous income	3,147,534	575,378	1,234,909	1,591,917	1,198,767	250,797	563,195	756,961	310,438
Cash dividends	82,875,065	83,510,341	60,571,654	63,668,421	66,866,305	55,266,106	55,459,408	57,140,005	59,732,396
Rents and royalties	5,047,881	3,262,801	2,491,299	2,797,839	2,787,942	2,853,838	2,960,928	2,774,387	2,549,485
Interest (taxable)	16,232,626	16,479,822	17,343,693	17,583,722	15,991,597	12,567,020	11,033,994	10,928,422	9,576,258
Total	191,205,474	143,668,853	111,607,204	119,707,445	112,872,076	90,821,467	103,343,470	110,466,479	101,968,655
Excess of losses over income			15,364	135,908	347,425	332,874	612,780	1,663,190	1,451,133
Interest (tax exempt) [1]	(2)	(2)	4,129,559	6,547,175	8,061,716	(2)	(2)	(2)	12,447,385
Total, including current year losses and tax-exempt interest			115,752,127	126,390,528	121,281,217	91,154,341	103,956,250	112,129,669	115,867,173
DEDUCTIONS									
Prior year losses							163,029	676,967	1,175,867
Business and partnership losses	1,231,268	628,223	1,370,533	2,226,416	4,574,911	3,499,124	2,129,611	5,163,258	1,982,609
Losses on sale of capital assets	125,292	2,445,082	8,714,135	19,463,969	27,213,793	22,959,690	9,873,239	12,286,102	8,821,651
Miscellaneous losses	514,178	1,749,377	1,204,041	2,267,512	1,390,380	1,029,237	771,809	1,782,228	996,770
Contributions, taxes, bad debts, and other deductions	9,431,596	13,743,182	13,368,042	12,101,413	12,684,978	12,978,001	15,359,964	13,785,429	14,852,454
Interest paid	3,723,024	2,943,141	3,074,324	4,420,174	5,494,255	5,175,119	4,113,892	4,175,541	4,360,816
Total	15,025,358	21,509,005	27,731,075	40,479,484	51,358,317	45,641,171	32,411,544	35,869,525	32,190,167
Interest (tax exempt) [1]	(2)	(2)	4,129,559	6,547,175	8,061,716	(2)	(2)	(2)	12,447,385
Total, including tax-exempt interest			31,860,634	47,026,659	59,420,033				44,637,552
Net income	176,180,116	122,159,848	83,891,493	79,363,869	61,861,184	45,513,170	71,544,706	76,260,144	71,229,621

[1] TAX-EXEMPT INCOME

	1918	1919	1920	1924
Obligations of the United States and its possessions	$1,261,400	$2,541,102	$3,234,639	$2,647,475
Obligations of States and Territories	2,528,427	3,002,010	3,862,479	8,485,100
Federal farm loan bonds	87,043	161,825	246,962	1,098,564
Tax-exempt interest on obligations of the United States and War Finance Corporation not wholly tax exempt	252,689	842,238	717,636	216,246
Total wholly tax-exempt interest	4,129,559	6,547,175	8,061,716	12,447,385

[2] Information not available.

TABLE No. 4.—*Summary of returns for 1916 to 1924, inclusive, of 155 individuals who reported net taxable income of $400,000 to $500,000 in 1916*

	1916	1917	1918	1919	1920	1921	1922	1923	1924
INCOME									
Salaries, wages and commissions	$5,784,277	$4,982,740	$4,532,230	$4,319,573	$4,259,114	$3,861,283	$4,352,512	$4,685,421	$4,129,260
Business and partnership profits	22,419,509	10,410,513	8,524,134	9,944,375	5,799,353	4,960,444	6,132,647	3,439,524	4,783,104
Profits on sale of capital assets	4,861,158	3,356,306	983,422	1,053,028	154,940	486,490	5,312,017	4,274,286	5,711,927
Miscellaneous income	315,862	701,368	261,734	508,617	141,135	82,071	114,815	122,671	145,288
Cash dividends	33,371,695	30,924,184	25,204,820	24,211,687	23,538,864	18,782,994	17,668,502	19,420,942	20,182,421
Rents and royalties	324,554	850,659	510,597	717,481	483,364	421,085	393,173	468,818	475,512
Interest (taxable)	6,336,689	6,857,396	6,896,166	6,604,754	6,332,826	4,360,132	4,003,371	3,303,347	5,304,306
Total	74,070,604	58,083,166	46,912,903	47,359,515	40,709,596	32,954,519	37,977,037	35,715,049	39,791,818
Excess of losses over income					390,519	380,992	59,669	79,909	519,618
Interest (tax exempt) [1]	(2)	(2)	1,562,939	2,590,534	3,387,691	(2)	(2)	(2)	4,394,083
Total, including current year losses and tax exempt interest			48,475,842	49,950,049	44,487,806	33,335,511	38,036,706	35,794,958	44,705,519
DEDUCTIONS									
Prior year losses							371,202	113,786	37,605
Business and partnership losses	365,177	256,195	260,534	156,801	438,001	1,054,446	1,009,014	413,506	[illegible],785,989
Losses on sale of capital assets	18,562	1,388,368	2,973,148	6,215,736	12,012,109	8,678,674	4,315,600	3,757,350	[illegible],139,240
Miscellaneous losses	193,158	605,983	629,872	546,122	668,149	59,772	272,984	197,555	[illegible],415,507
Contributions, taxes, bad debts, and other deductions	2,827,604	3,859,859	4,333,037	3,915,209	3,990,622	3,526,394	3,738,609	5,248,[illegible]	[illegible],406,[illegible]
Interest paid	1,342,958	1,439,843	2,585,851	3,118,503	3,583,676	3,159,242	2,427,964	2,418,[illegible]	[illegible],216,735
Total	4,745,529	7,550,248	10,782,442	13,952,371	20,702,557	16,508,528	12,135,353	12,399,714	[illegible],801,357
Interest (tax exempt) [1]	(2)	(2)	1,562,939	2,590,534	3,387,691	(2)	(2)	(2)	4,394,083
Total, including tax-exempt interest			12,345,381	16,542,905	24,090,248				[illegible],195,440
Net income	69,325,075	50,532,918	36,130,461	33,407,144	20,397,558	16,826,983	25,901,353	23,405,244	[illegible],510,079

[1] TAX-EXEMPT INCOME

	1918	1919	1920	1924
Obligations of the United States and its possessions	$751,667	$1,052,158	$1,570,506	$663,390
Obligations of States and Territories	571,365	911,547	1,071,722	2,881,760
Federal farm loan bonds	122,983	247,960	342,028	579,667
Tax-exempt interest on obligations of the United States and War Finance Corporation not wholly tax exempt	116,924	378,869	393,436	279,266
Total wholly tax-exempt interest	1,562,939	2,590,534	3,387,691	4,394,083

[2] Information not available.

TABLE No. 5.—*Summary of returns for 1916 to 1924, inclusive, of 315 individuals who reported net taxable income of $300,000 to $400,000 in 1916*

	1916	1917	1918	1919	1920	1921	1922	1923	1924
INCOME									
Salaries, wages, and commissions	$6,421,303	$9,705,825	$8,458,647	$9,796,823	$9,780,126	$8,689,637	$8,307,894	$9,507,842	$8,315,501
Business and partnership profits	44,827,512	22,589,195	25,030,059	26,412,101	13,657,189	10,751,993	13,821,777	11,640,476	11,031,874
Profits on sale of capital assets	5,162,782	2,681,229	732,084	4,642,662	479,987	751,991	11,058,231	7,571,130	10,309,109
Miscellaneous income	75,566	292,686	175,711	353,514	342,558	208,126	229,959	344,596	314,916
Cash dividends	47,437,950	48,942,613	37,133,054	36,557,639	38,659,147	32,077,903	34,764,188	39,782,230	39,820,544
Rents and royalties	3,318,691	2,184,624	2,332,098	1,536,675	1,277,359	1,582,974	1,375,915	1,242,321	1,406,439
Interest (taxable)	10,104,911	12,019,128	12,258,796	12,305,313	10,569,195	8,121,797	7,165,694	5,899,365	6,500,475
Total	117,048,515	98,415,300	86,120,449	91,604,727	74,765,561	62,184,421	76,723,658	76,987,960	77,698,858
Excess of losses over income		2,022,526	57,067	2,729,198	2,561,849	1,299,026	924,197	685,856	837,699
Interest (tax exempt) [1]	(2)	(2)	2,364,547	4,420,496	5,141,284	(2)	(2)	(2)	5,376,418
Total, including current year losses and tax exempt interest		100,437,826	88,542,063	98,754,421	82,468,694	63,483,447	77,647,855	77,673,816	83,912,975
DEDUCTIONS									
Prior year losses					1,024,526		1,084,090	967,172	622,391
Business and partnership losses	908,365	579,034	534,528	2,237,267	3,094,541	2,487,134	1,587,661	1,382,773	1,363,611
Losses on sale of capital assets	184,411	3,298,164	5,031,531	12,434,298	19,871,412	14,907,844	7,558,299	9,764,587	5,527,273
Miscellaneous losses	469,319	620,630	1,165,731	927,832	1,576,121	559,351	1,102,318	727,345	1,851,368
Contributions, taxes, bad debts, and other deductions	5,105,255	6,476,454	7,292,526	6,757,978	6,420,944	7,189,541	10,327,663	9,102,754	9,097,278
Interest paid	2,474,226	2,537,912	3,114,139	3,875,316	4,931,467	5,082,317	5,975,778	5,712,148	4,620,765
Total	9,141,576	13,512,194	17,138,455	26,232,691	36,919,011	30,226,187	27,635,809	27,656,759	23,082,686
Interest (tax exempt) [1]	(2)	(2)	2,364,547	4,420,496	5,141,284	(2)	(2)	(2)	5,376,418
Total, including tax-exempt interest			19,503,002	30,653,187	42,060,295				28,459,104
Net income	107,906,939	86,925,632	69,039,061	68,101,234	40,408,399	33,257,260	50,012,046	50,017,137	55,453,871

[1] TAX EXEMPT INCOME

	1918	1919	1920	1924
Obligations of the United States and its possessions	$621,091	$1,328,366	$1,376,703	$819,837
Obligations of States and Territories	1,438,324	2,086,173	2,832,141	3,624,127
Federal farm loan bonds	66,952	146,282	212,997	614,910
Tax-exempt interest on obligations of the United States and War Finance Corporation not wholly tax exempt	238,180	859,675	719,443	317,544
Total wholly tax-exempt interest	2,364,547	4,420,496	5,141,284	5,376,418

[2] Information not available.

TABLE No. 6.—*Summary of returns for 1916 to 1924, inclusive, of 703 individuals who reported net taxable income of $200,000 to $300,000 in 1916*

	1916	1917	1918	1919	1920	1921	1922	1923	1924
INCOME									
Salaries, wages, and commissions	$14,804,996	$20,191,339	$18,957,455	$18,445,768	$18,534,170	$16,105,365	$15,099,266	$15,997,234	$16,198,159
Business and partnership profits	59,339,154	29,429,476	32,055,485	37,563,498	24,099,380	17,849,734	21,279,145	16,438,505	16,279,672
Profits on sale of capital assets	8,307,930	5,639,395	1,424,824	6,870,314	2,521,602	4,054,947	25,338,096	10,143,590	16,036,573
Miscellaneous income	844,091	705,718	537,489	667,776	731,212	678,324	730,219	476,192	590,253
Cash dividends	80,843,343	82,195,558	63,420,868	59,376,517	63,251,201	52,807,436	57,742,611	62,893,942	62,561,515
Rents and royalties	7,126,080	3,639,553	2,951,164	3,344,602	2,817,514	3,135,873	3,597,178	3,198,614	3,330,560
Interest (taxable)	17,028,827	19,225,485	19,653,252	19,686,134	19,011,672	14,273,247	13,085,663	12,342,545	11,034,172
Total	186,292,729	161,026,524	139,030,517	145,884,609	130,966,751	108,904,926	136,862,796	121,490,922	127,050,904
Excess of losses over income				23,533	417,062	1,701,115	1,591,393	1,966,372	1,455,893
Interest (tax-exempt) [1]	(2)	(2)	4,139,253	7,073,316	8,593,699	(2)	(2)	(2)	12,241,034
Total, including current year losses and tax-exempt interest			143,169,770	152,981,458	139,977,512	110,606,041	138,454,191	123,457,294	140,747,831
DEDUCTIONS									
Prior year losses							1,791,900	2,033,927	1,360,967
Business and partnership losses	831,928	2,066,161	1,054,980	2,198,709	5,852,696	6,536,211	3,966,504	5,322,886	5,845,815
Losses on sale of capital assets	143,431	944,031	11,180,388	18,625,572	34,209,045	25,895,387	13,045,175	14,179,508	7,064,635
Miscellaneous losses	1,171,[illegible]	1,298,844	3,136,100	2,321,737	2,612,441	2,956,753	5,019,867	3,921,377	2,212,543
Contributions, taxes, bad debts, and other deductions	8,411,887	11,264,486	11,337,966	11,906,204	11,735,247	12,342,525	13,075,883	14,328,183	14,120,859
Interest paid	4,745,807	4,166,184	5,292,757	6,547,306	7,710,829	7,155,547	5,557,648	5,733,193	5,346,811
Total	15,272,947	19,643,706	32,002,131	41,599,528	62,150,258	54,886,423	41,886,977	43,519,370	35,971,650
Interest (tax exempt) [1]	(2)	(2)	4,139,253	7,073,316	8,593,699	(2)	(2)	(2)	12,241,034
Total, including tax-exempt interest			36,141,384	48,672,844	70,743,957				48,212,684
Net income	171,[illegible]	141,382,818	107,028,386	104,308,614	69,233,555	55,719,618	96,567,214	79,937,918	92,535,147

[1] TAX-EXEMPT INCOME

	1918	1919	1920	1924
Obligations of the United States and its possessions	$1,363,888	$2,328,040	$3,058,862	$[illegible],847,789
Obligations of the States and Territories	2,198,193	2,930,121	3,778,540	8,307,022
Federal farm loan bonds	72,832	142,700	271,932	1,425,034
Tax exempt interest on obligations of the United States and War Finance Corporation not wholly tax exempt	504,340	1,672,455	1,484,365	661,189
Total wholly tax-exempt interest	4,139,253	7,073,316	8,593,699	12,241,034

[2] Information not available.

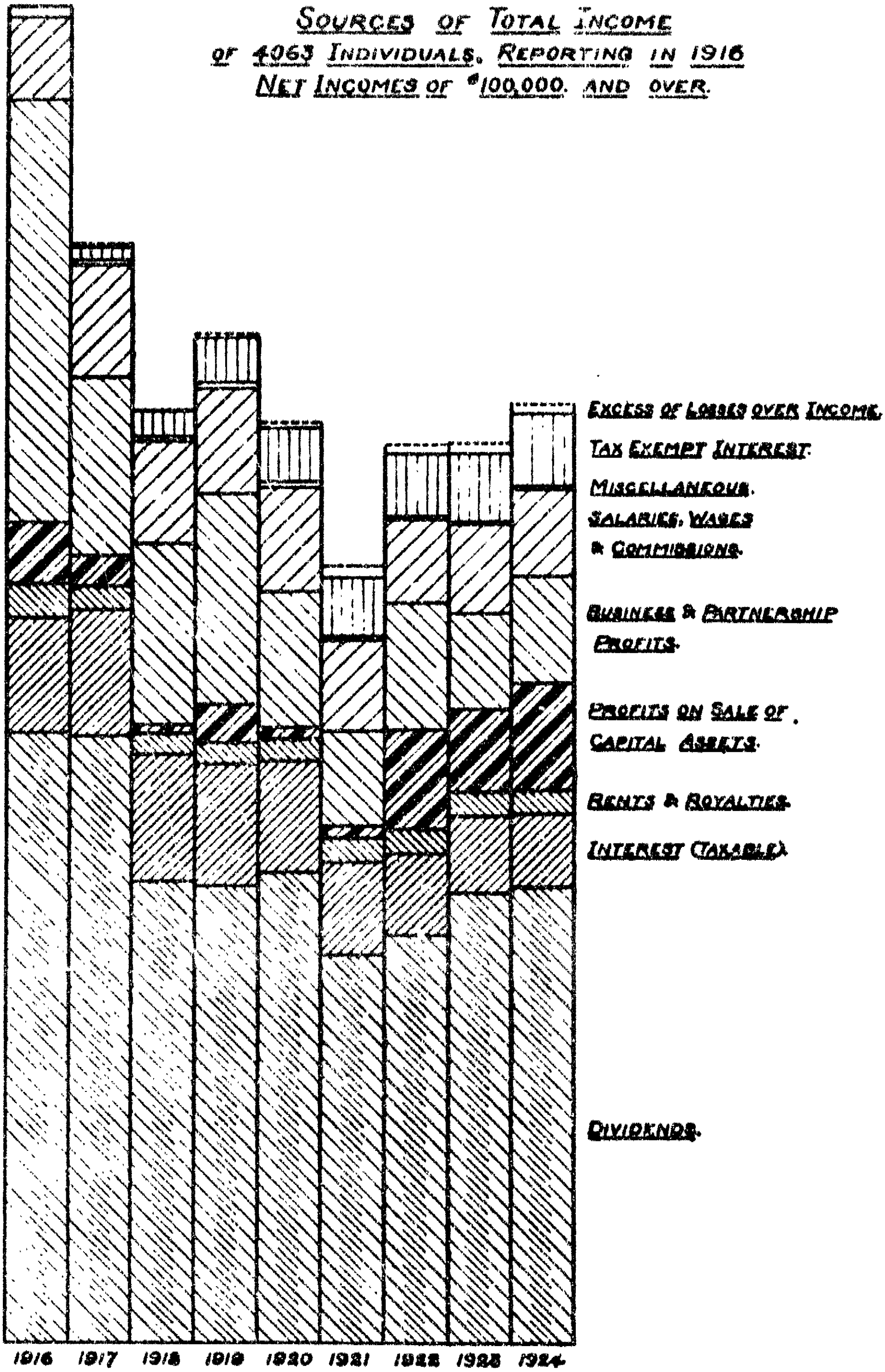
TABLE No. 7.—*Summary of returns for 1916 to 1924 inclusive, of 2,512 individuals who reported net taxable income of $100,000 to $200,000 in 1916*

	1916	1917	1918	1919	1920	1921	1922	1923	1924
INCOME									
Salaries, wages, and commissions	$35,493,[illegible]	$74,081,489	$80,064,375	$51,191,170	$52,561,825	$45,395,933	$41,940,347	$44,027,524	$44,319,501
Business and partnership profits	122,48[illegible]	65,498,204	75,517,098	31,611,053	65,221,915	41,921,609	72,972,786	44,054,[illegible]	45,250,025
Profits on sale of capital assets	9,025,913	8,338,062	2,982,772	15,245,600	4,249,347	3,017,437	29,756,298	28,237,681	17,006,954
Miscellaneous income	3,021,056	1,698,044	1,377,827	2,289,344	1,952,514	1,283,618	1,250,697	986,[illegible]	[illegible]956,956
Cash dividends	160,987,921	169,551,144	135,547,396	134,713,811	149,794,518	123,314,684	134,567,018	148,362,289	1[illegible],552,267
Rents and royalties	12,520,712	8,208,506	6,884,926	7,549,750	8,177,239	9,328,086	10,062,725	10,188,[illegible]	9,967,560
Interest (taxable)	34,280,080	36,923,599	37,296,134	38,525,001	37,875,626	32,741,104	23,213,856	28,012,264	27,626,575
Total	378,29[illegible]	344,299,039	309,701,128	341,428,709	319,825,984	257,002,471	299,769,719	298,880,340	317,679,866
Excess of losses over income		697,488	20,231	559,503	1,572,969	5,402,448	2,854,[illegible]	5,161,979	3,338,342
Interest (tax exempt)[1]	(2)	(2)	6,793,516	12,091,683	13,829,725	(2)	(2)	(2)	18,692,779
Total, including current-year losses and tax exempt interest		344,996,527	316,514,875	354,079,895	335,226,578	262,404,919	302,623,787	304,042,319	340,310,987
DEDUCTIONS									
Prior year losses				15,237	191,974				
Business and partnership losses	1,512,028	2,564,396	2,360,644	3,941,335	9,565,109		2,910,547	3,388,037	4,016,626
Losses on sale of capital assets	1,377,392	3,825,233	17,543,907	35,728,984	74,039,045	12,105,922	7,264,592	8,305,258	5,229,839
Miscellaneous losses	2,433,023	2,562,304	4,575,036	4,728,345	4,314,627	52,270,130	24,128,757	34,063,519	17,056,966
Contributions, taxes, bad debts, and other deductions	16,598,832	22,516,317	25,353,642	25,709,375	26,247,319	3,811,819	3,725,482	4,807,243	5,863,692
Interest paid	10,003,347	9,425,262	10,709,401	12,887,071	15,656,333	26,442,056	33,046,973	33,953,301	36,154,286
						15,776,756	15,017,943	14,875,056	14,606,064
Total	31,994,632	40,893,512	60,542,630	83,010,347	130,014,407	110,406,713	86,094,304	99,392,416	82,927,493
Interest (tax exempt)[1]	(2)	(2)	6,793,516	12,091,683	13,829,725	(2)	(2)	(2)	18,692,779
Total, including tax-exempt interest			67,336,146	95,102,030	143,844,132				101,620,272
Net income	346,301,1[illegible]5	304,103,015	249,178,729	258,977,865	191,382,446	151,998,206	216,529,483	204,649,903	238,690,715

[1] TAX-EXEMPT INCOME

	1918	1919	1920	1924
Obligations of the United States and its possessions	$1,958,552	$2,969,418	$2,490,564	$2,990,364
Obligations of States and Territories	3,211,105	4,115,868	5,602,204	11,151,236
Federal Farm Loan bonds	131,933	315,217	575,356	2,614,424
Tax-exempt interest on obligations of the United States and War Finance Corporation, not wholly tax exempt	1,491,926	4,691,180	4,161,[illegible]	1,906,755
Total wholly tax-exempt income	6,793,516	12,091,683	13,829,725	18,692,779

[2] Information not available.


Sources of Total Income
of 4063 Individuals, Reporting in 1916
Net Incomes of $100,000. and over.
Excess of Losses over Income.
Tax Exempt Interest.
Miscellaneous.
Salaries, Wages & Commissions.
Business & Partnership Profits.
Profits on Sale of Capital Assets.
Rents & Royalties.
Interest (Taxable).
Dividends.
1916
1917
1918
1919
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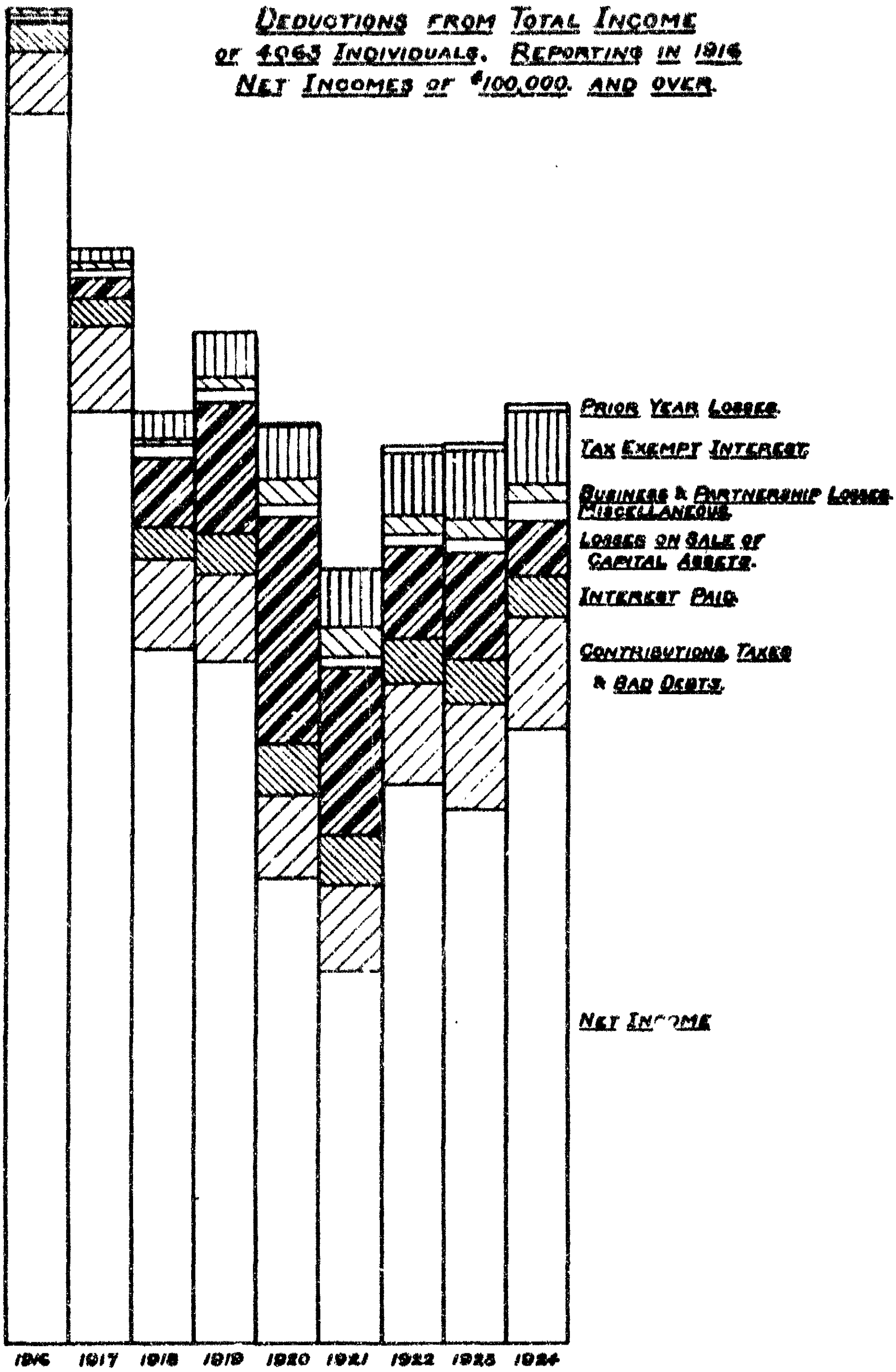
1924


DEDUCTIONS FROM TOTAL INCOME
OF 4065 INDIVIDUALS. REPORTING IN 1916
NET INCOMES OF $100,000. AND OVER.
PRIOR YEAR LOSSES.
TAX EXEMPT INTEREST.
BUSINESS & PARTNERSHIP LOSSES.
MISCELLANEOUS.
LOSSES ON SALE OF CAPITAL ASSETS.
INTEREST PAID.
CONTRIBUTIONS, TAXES & BAD DEBTS.
NET INCOME
1916
1917
1918
1919
1920
1921
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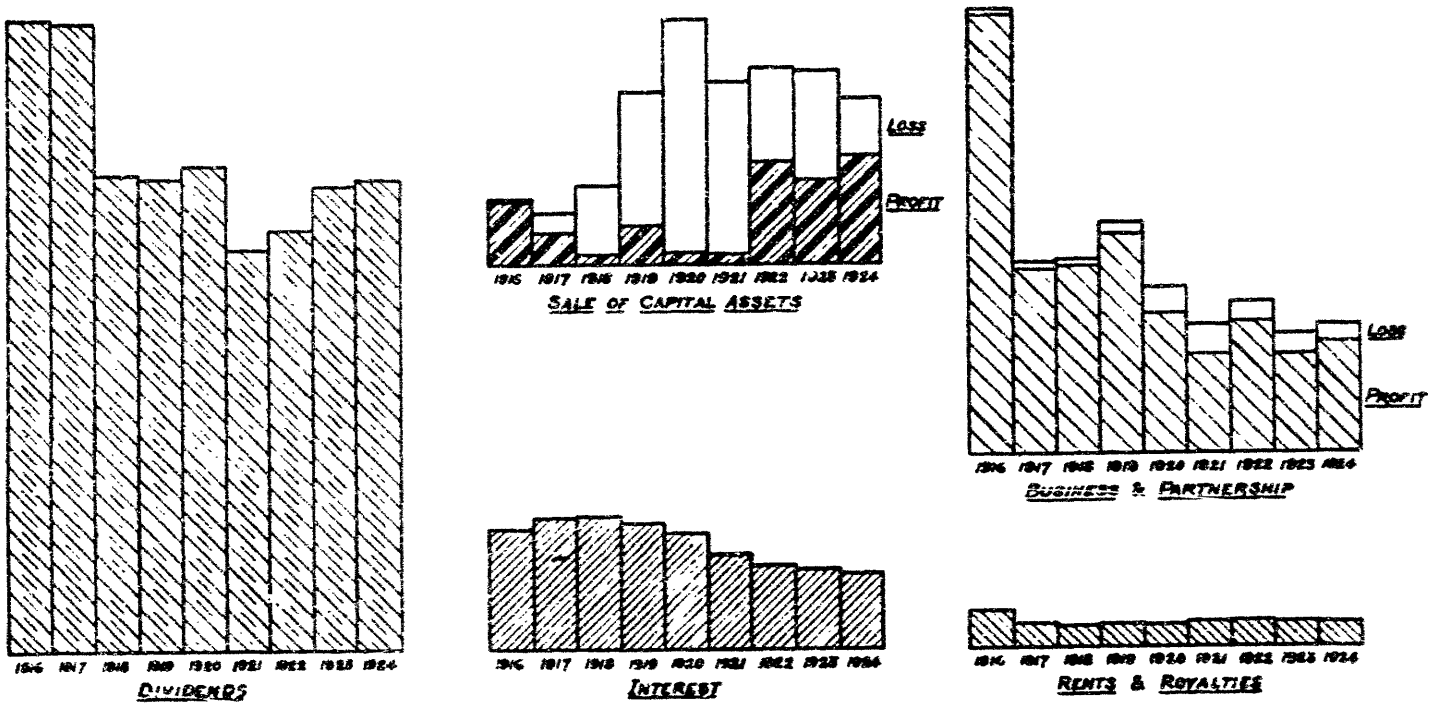
1923
1924

PRINCIPAL ELEMENTS OF INCOME
OF 4063 INDIVIDUALS, REPORTING IN 1916
NET INCOME OF $100,000. AND OVER.



UNDISTRIBUTED EARNINGS OF CORPORATIONS, 1923

An investigation has been made of the distribution of corporate earnings and of the use made of undistributed corporate earnings for the year 1923. This investigation sought to determine the following:

1. The extent to which corporate net earnings are subjected to individual surtax through distribution as dividends.
2. The distribution of the undivided corporate profits into classes based upon the ratio of distributed earnings to total net profits, and the ratio of the total earnings in each of the said classes to the combined capital, surplus, and undivided profits.
3. The extent to which undistributed corporate earnings are reinvested in the corporate business.
4. The surtax brackets into which the undistributed corporate earnings would fall if distributed as dividends.

DIVIDENDS REPORTED

The dividends paid by domestic corporations are shown by the returns for 1922 and 1923 and reported in the "Statistics of income" for those years. This information is not available for the years prior to 1922.

The dividends reported as income by individuals and corporations and the dividends reported as paid by corporations in 1922 and 1923, according to "Statistics of income," are as follows:

TABLE 1.—*Dividends reported as income by individuals and corporations and as paid by corporations, 1922 and 1923*

	1922	1923
Dividends (domestic corporations) reported as income:		
By individuals	$2,664,219,081	$3,126,503,482
By corporations	803,122,508	870,087,795
Total reported as income	3,467,341,589	3,996,591,277
Dividends reported paid by domestic corporations	3,436,715,101	4,169,117,678
Excess reported paid		172,526,401
Excess reported as income	30,626,488	

The foregoing figures show that practically all of the dividends paid by domestic corporations go to either corporations or to individuals who report income. While the dividends paid by domestic corporations during the years prior to 1922 are not shown by the "Statistics of income," the amount of such dividends can be approximately ascertained from the dividends reported as income.

The dividends of domestic corporations, reported as income for the years 1918 to 1923, inclusive, by individuals and corporations are as follows:

TABLE 2.—*Dividends of domestic corporations reported as income*

Year	By individuals		By corporations		Total
	Amounts	Per cent of total	Amounts	Per cent of total	
1918	$2,468,749,244	85.4	$420,653,468	14.6	$2,889,402,712
1919	2,453,774,825	86.7	375,838,134	13.3	2,829,612,959
1920	2,735,845,795	83.7	531,386,531	16.3	3,267,232,326
1921	2,476,952,390	83.0	509,117,760	17.0	2,986,070,150
1922	2,664,219,081	76.8	803,122,508	23.2	3,467,341,589
1923	3,126,503,482	78.2	870,087,795	21.8	3,996,591,277

The total net taxable income reported by corporations, the tax paid, and the net taxable income after payment of the tax for 1918 to 1923, inclusive, are, according to "Statistics of Income," as follows:

TABLE 3

Year	Net taxable income	Tax	Net taxable income less tax
1918	$8,361,511,249	$3,158,764,422	$5,202,746,827
1919	9,411,418,458	2,175,341,578	7,236,076,880
1920	7,902,654,813	1,625,234,643	6,277,420,170
1921	4,336,047,813	701,575,432	3,634,472,381
1922	6,963,811,143	783,776,268	6,180,034,875
1923	8,321,529,134	937,106,798	7,384,422,336

The dividends received by corporations are not included in the amounts of net taxable income above shown. The net earnings of corporations which are not distributed as dividends to individuals and taxed as individual income can be approximately ascertained by deducting the dividends reported as income by individuals from the net taxable income of corporations less tax. The undivided net earnings of corporations for the years 1918 to 1923, inclusive, are as follows:

TABLE 4

Year	Net taxable income of corporations less tax	Dividends reported as income by individuals	Undistributed net taxable earnings of corporations	
			Amounts	Per cent of totals
1918	$5,202,746,827	$2,468,749,244	$2,733,997,583	52.5
1919	7,236,076,880	2,453,774,825	4,782,302,055	66.1
1920	6,277,420,170	2,735,845,795	3,541,574,375	56.4
1921	3,634,472,381	2,476,952,390	1,157,519,982	31.8
1922	6,180,034,875	2,664,219,081	3,515,815,794	56.9
1923	7,384,422,336	3,126,503,482	4,257,918,854	57.7
Total	35,915,173,469	15,926,044,826	19,989,128,643	
Average	5,985,862,245	2,654,340,804	3,331,521,441	55.7

CORPORATIONS WITH NET INCOMES EXCEEDING $50,000 AND WHICH DISTRIBUTED LESS THAN 60 PER CENT OF NET INCOME AS CASH DIVIDENDS

This committee called upon the Secretary of the Treasury to furnish information relative to all corporations reporting net income (taxable and nontaxable) exceeding $50,000, and which distributed less than 60 per cent of their net income as cash dividends. From such information various compilations were prepared which are shown in the tables in this report. These compilations are summarized in the following tables. The information furnished is known to be incomplete, yet the undivided current net earnings for 1923 of these corporations aggregate $2,640,880,095. Prior-year losses are shown aggregating $273,980,352. The undistributed earnings of this group after recouping prior year losses aggregated $2,366,899,743.

Table 5 shows the total net income, less tax, cash dividends, undivided current profits, and prior-year losses of 12,621 corporations which reported net incomes (taxable and nontaxable) for 1923 exceeding $50,000, and which distributed less than 60 per cent of 1923 net income as cash dividends, classified in accordance with per cent of net income distributed as dividends.

TABLE 5

	Net income less tax	Cash dividends	Undivided current profits	Prior-year losses
Per cent of net income distributed as cash dividends:				
50 to 60 per cent	$311, 767, 749	$181, 589, 818	$130, 177, 931	$5, 542, 079
40 to 50 per cent	514, 148, 414	258, 007, 572	256, 140, 842	11, 581, 001
30 to 40 per cent	637, 903, 040	246, 504, 610	391, 398, 430	28, 383, 746
20 to 30 per cent	789, 838, 428	222, 871, 112	566, 967, 316	30, 839, 951
10 to 20 per cent	565, 767, 338	97, 555, 962	468, 211, 376	28, 891, 261
Less than 10 per cent	308, 686, 105	18, 157, 314	290, 528, 791	39, 451, 183
No dividends	537, 455, 409		537, 455, 409	129, 291, 131
Total	3, 665, 566, 483	1, 024, 686, 388	2, 640, 880, 095	273, 980, 352

Table 6 shows the net income, less tax, cash dividends, undivided current profits, and prior-year losses of the same 12,621 corporations for 1923, classified according to the ratio of 1923 earnings to the combined capital, surplus, and undivided earnings expressed in per cent.

TABLE 6

	Net income less tax	Cash dividends	Undivided current profits	Prior-year losses
Ratio of net earnings for 1923 to combined capital, surplus, and undivided earnings, expressed in per cent:				
Less than 5 per cent	$79, 432, 466	$11, 351, 281	$68, 081, 185	$57, 714, 899
5 to 10 per cent	316, 018, 739	81, 634, 682	234, 384, 057	84, 344, 812
10 to 25 per cent	1, 796, 013, 375	578, 087, 404	1, 217, 925, 971	90, 192, 081
25 to 50 per cent	1, 018, 643, 957	265, 532, 964	753, 110, 993	25, 019, 209
Over 50 per cent	455, 457, 946	88, 080, 057	367, 377, 889	16, 709, 351
Total	3, 665, 566, 483	1, 024, 686, 388	2, 640, 880, 095	273, 980, 352

DEALERS IN SECURITIES AND REAL ESTATE AND HOLDING AND INVESTMENT COMPANIES

Among the corporations included in the foregoing tables are 1087 corporations whose business is confined to holding and dealing in rented real estate, corporate stock, and bonds.

The total net income, less tax, of the group in 1923 was $215,484,697. The cash dividends in 1923 were $38,612,784 and the undivided current profits in 1923 were $176,871,913. Practically all of these corporations were being utilized to escape the individual surtax. Yet, it is extremely doubtful whether any of them come within the provisions of section 220 of the act of 1924, which imposes a 50 per cent additional tax upon corporations, formed or availed of for the purpose of preventing the imposition of the surtax upon its shareholders through the device of accumulating its earnings.

Dealers in stock and bonds are ordinarily partnerships, but many such partnerships have incorporated since 1918 for the purpose of escaping individual surtaxes. As the underwriting of issues of stock and bonds nearly always involve large bank loans, it can not be said that any accumulation of profits is not reasonably required for the purpose of the business.

Practically all large investors in stock and bonds are constantly buying and selling such securities. Under the rulings of the Income Tax Unit, all such investor need to do to constitute himself a dealer is to maintain an office with an appropriate sign on the door. Thus, through the medium of a corporation, which maintains an office with a sign announcing that it deals in securities, surplus income may be accumulated without paying the individual surtax.

As the business of banks is to loan money, the regulations (reg. 65, art. 353) provide that so long as accumulated profits are represented by loans or required for future loans, section 220 does not apply.

An individual owner of an apartment house or office building is subject to surtax on the profit derived from such investment, even though the building may be mortgaged and such profits may be required to pay such indebtedness. If such owner forms a corporation to carry the investment, the use of accumulated profits to pay off the debt prevents the application of section 220.

USE OF UNDIVIDED PROFITS

The amounts shown in each class in Table 5 are subdivided into the classes shown in Table 6, and the results are shown in Table 7.

Table 8 is a summary of the assets at the beginning and end of 1923, of the 12,621 corporations, the earnings and dividends of which are shown in Table 7.

The amounts shown in Table 8 under the heading "Investments" consist of real estate, stock, bonds, etc., carried as investments. Such investments as plant equipment, and inventory items and bills receivable are included under the heading "All other assets."

The "cash" and "investments" increased $1,118,689,355, and the remainder of the undivided current profits or $1,522,190,740 was reinvested in the business of these corporations. Thus, approximately 60 per cent of the undivided earnings of corporations of this class are reinvested in the operation of the business and 40 per cent are placed in outside investments.

ALLOCATION OF UNDIVIDED EARNINGS TO SURTAX BRACKETS

An investigation has been made for the purpose of determining the surtax brackets in which this $2,640,880,095 of undivided current earnings would fall, if distributed as dividends. For this purpose 683 typical corporations were selected. This selection was made by taking at random 10 per cent of the corporations in each class into which the 12,621 corporations had been divided for statistical purposes. The necessary information could be secured for only 683 of the corporations selected.

Copies of the returns of dividends, of these corporations, showing the names of the stockholders and the amount of dividends paid to each, were secured from the Treasury Department. The net taxable incomes of these stockholders for 1923 were secured.

The per cent of the total dividends paid to each stockholder by each corporation was computed and that per cent of the undivided 1923 profits was allocated to that stockholder. The undivided profits, allocated to each stockholder, were then distributed among the tax brackets, in which an equal amount of additional income would fall, if added to the net taxable income returned by the stockholders.

The net incomes of the stockholders of these 683 corporations aggregated $137,459,459 and the undivided profits allocated to them amounted to $88,576,215.

Table 9 shows the distribution of this $88,576,215 of undivided profits, the percent thereof falling in each surtax bracket, and the distribution of the $2,640,880,095 of undivided current profits in 1923 of 12,621 corporations, with net incomes exceeding $50,000, and which distributed less than 60 per cent of net income as dividends, and the surtax which would be applicable to such undivided profits if distributed as dividends and taxed at the rates fixed by the 1926 revenue bill as it passed the House.

TABLE 7.—*Taxable and nontaxable income, dividends, and undivided current profits for 1923 of 12,621 corporations with net incomes exceeding $50,000 and which distributed less than 60 per cent of net income as dividends, classified according to per cent of net income distributed as dividends and ratio of net earnings to combined capital, surplus, and undivided profits*

SHOWING PRIOR-YEAR LOSSES

Ratio of net earnings for 1923 to combined capital, surplus, and undivided profits expressed in per cent	Number of corporations	Prior year losses	Taxable net income	Nontaxable income				
				Interest on United States obligations	Interest on State, etc., obligations	Interest, farm loan	Dividends	Other nontaxable income
Corporations which distributed from 50 to 60 per cent of total net income as cash dividends:								
Less than 5 per cent	24	$158, 017	$3, 920, 349	$38, 195	$8, 222		$1, 515, 650	$1, 210
5 to 10 per cent	199	4, 040, 059	55, 166, 621	1, 609, 046	582, 263	$24, 259	2, 197, 331	162, 386
10 to 25 per cent	551	1, 044, 755	195, 050, 606	4, 757, 588	648, 450	69, 063	16, 507, 325	257, 509
25 to 50 per cent	204	38, 665	51, 824, 858	770, 436	135, 303	24, 462	690, 856	23, 882
Over 50 per cent	91	260, 583	15, 335, 301	84, 847	21, 647	4, 225	18, 462	14, 279
Total	1, 069	5, 542, 079	321, 297, 735	7, 260, 112	1, 395, 885	122, 009	20, 929, 636	459, 266
Corporations which distributed from 40 to 50 per cent of total net income as cash dividends:								
Less than 5 per cent	28	519, 681	3, 227, 643	58, 056	8, 250		918, 057	23, 205
5 to 10 per cent	201	2, 972, 817	46, 281, 523	1, 797, 893	577, 470	115, 615	1, 777, 156	122, 461
10 to 25 per cent	930	7, 632, 160	354, 452, 594	10, 835, 786	3, 405, 821	416, 829	7, 448, 567	1, 765, 173
25 to 50 per cent	282	120, 577	105, 381, 280	1, 601, 598	227, 631	60, 299	488, 552	699, 104
Over 50 per cent	143	335, 766	39, 546, 365	427, 127	26, 440	68, 369	469, 559	139, 367
Total	1, 584	11, 581, 001	548, 889, 405	14, 718, 460	4, 245, 612	661, 112	11, 102, 211	2, 749, 310
Corporations which distributed from 30 to 40 per cent of total net income as cash dividends:								
Less than 5 per cent	32	4, 883, 831	6, 572, 749	15, 399	10, 691		315, 879	2, 223
5 to 10 per cent	171	11, 477, 499	33, 755, 220	983, 207	334, 174	23, 795	1, 402, 277	322, 565
10 to 25 per cent	1, 064	10, 071, 090	385, 557, 546	8, 216, 846	2, 640, 370	227, 816	21, 193, 433	3, 233, 208
25 to 50 per cent	438	1, 489, 037	186, 515, 719	1, 890, 382	315, 785	128, 703	1, 554, 477	2, 709, 802
Over 50 per cent	157	462, 289	60, 736, 166	778, 483	88, 307	52, 880	475, 404	330, 270
Total	1, 862	28, 383, 746	673, 137, 400	11, 884, 317	3, 389, 327	433, 194	24, 941, 470	6, 597, 906

TABLE 7.—*Taxable and nontaxable income, dividends, and undivided current profits for 1923 of 12,621 corporations with net incomes exceeding $50,000 and which distributed less than 60 per cent of net income as dividends, classified according to per cent of net income distributed as dividends and ratio of net earnings to combined capital, surplus, and undivided profits*—Continued

SHOWING PRIOR-YEAR LOSSES—Conteinud

Ratio of net earnings for 1923 to combined capital, surplus, and undivided profits expressed in per cent	Number of corporations	Prior year losses	Taxable net income	Nontaxable income: Interest on United States obligations	Interest on State, etc., obligations	Interest, farm loan	Dividends	Other nontaxable income
Corporations which distributed from 20 to 30 per cent of total net income as cash dividends:								
Less than 5 per cent	22	$7,182,249	$9,390,621	$147,948	$208,604	$6,369	$743,100	....
5 to 10 per cent	121	4,002,767	23,704,540	735,135	27,067	3,268	787,336	$555,955
10 to 25 per cent	951	15,699,242	436,980,178	13,517,946	2,146,062	149,162	17,266,500	5,463,958
25 to 50 per cent	612	1,408,142	264,854,837	2,743,012	431,558	122,421	3,852,557	615,758
Over 50 per cent	216	1,547,551	101,389,334	2,291,022	56,581	24,949	2,048,209	735,967
Total	1,922	30,839,951	836,319,510	19,435,063	2,869,872	306,179	24,697,702	7,371,638
Corporations which distributed from 10 to 20 per cent of total net income as cash dividends:								
Less than 5 per cent	19	2,242,291	4,446,437	31,662	33,224	6,300	3,566,823	14,056
5 to 10 per cent	117	15,809,459	32,255,960	429,272	109,724	46,201	3,633,867	236,260
10 to 25 per cent	636	6,808,540	220,331,012	2,599,509	943,251	258,193	6,227,744	2,470,602
25 to 50 per cent	754	3,814,760	281,520,968	3,319,304	795,509	521,502	2,806,441	2,044,341
Over 50 per cent	268	216,211	68,379,495	917,756	153,196	4,592	620,305	1,242,725
Total	1,794	28,891,261	606,933,872	7,297,503	2,034,904	836,758	16,855,180	6,007,987
Corporations which distributed less than 10 per cent of total net income as cash dividends:								
Less than 5 per cent	14	17,120,281	12,585,209	427,479	16,364	....	542,072	....
5 to 10 per cent	63	4,709,857	27,900,225	475,088	49,756	37,075	6,145,252	406,421
10 to 25 per cent	279	14,257,931	91,571,769	1,570,736	347,443	186,919	2,948,899	366,711
25 to 50 per cent	356	1,966,931	103,859,104	1,006,262	398,053	25,639	3,305,725	2,151,510
Over 50 per cent	280	1,396,183	86,735,987	622,719	139,669	129,386	1,324,072	322,340
Total	992	39,451,183	322,652,294	4,102,284	951,315	379,019	14,298,020	3,246,962
Corporations which distributed no cash dividends:								
Less than 5 per cent	194	25,608,549	30,436,236	1,356,480	207,170	61,317	6,372,470	378,307
5 to 10 per cent	415	41,332,354	98,023,945	1,234,615	656,104	167,282	4,383,265	623,912
10 to 25 per cent	1,155	33,678,363	181,606,571	2,424,288	657,198	138,448	12,955,275	2,298,440

25 to 50 per cent	849	16,181,097	117,962,033	843,357	150,030	9,704	5,212,574	2,428,743
Over 50 per cent	785	12,490,768	119,346,535	370,014	335,493	28,500	8,756,164	867,918
Total	3,398	129,291,131	547,375,320	6,228,754	2,005,985	405,251	37,679,748	6,595,320
Grand total	12,621	273,980,352	3,856,605,536	70,926,493	16,892,900	3,143,552	150,471,957	33,028,409

Ratio of net earnings for 1923 to combined capital, surplus, and undivided profits expressed in per cent	Total nontaxable income	Total net income	Federal income tax, 1923	Total net income less tax	Dividends paid		Undivided current profits
					Cash	Stock	
Corporations which distributed from 50 to 60 per cent of total net income as cash dividends:							
Less than 5 per cent	$1,563,277	$5,416,377	$469,520	$4,946,857	$2,947,244	$321,000	$1,999,613
5 to 10 per cent	4,575,285	59,702,395	6,465,027	53,237,368	32,906,901	5,160,545	20,330,467
10 to 25 per cent	22,239,935	217,252,184	24,249,270	193,002,914	108,185,127	18,899,454	84,817,787
25 to 50 per cent	1,644,941	53,460,252	6,472,683	46,987,569	29,010,489	3,045,978	17,977,080
Over 50 per cent	143,460	15,478,761	1,885,720	13,593,041	8,540,057	2,147,062	5,052,984
Total	30,166,898	351,309,969	39,542,220	311,767,749	181,589,818	29,574,039	130,177,931
Corporations which distributed from 40 to 50 per cent of total net income as cash dividends:							
Less than 5 per cent	1,005,568	4,121,834	378,338	3,743,496	1,836,319	50,000	1,907,177
5 to 10 per cent	4,390,595	50,565,951	5,403,047	45,162,904	22,656,845	4,424,548	22,506,056
10 to 25 per cent	23,872,196	377,832,455	43,452,372	334,380,083	166,182,889	23,551,202	168,197,194
25 to 50 per cent	3,077,484	108,458,764	13,367,322	95,091,442	48,835,860	7,433,442	46,255,582
Over 50 per cent	1,130,862	40,677,227	4,906,738	35,770,489	18,495,658	1,442,363	17,274,831
Total	33,476,705	581,656,231	67,507,817	514,148,414	258,007,572	36,901,855	256,140,842
Corporations which distributed from 30 to 40 per cent of total net income as cash dividends:							
Less than 5 per cent	343,992	6,916,741	591,817	6,324,924	2,422,801	600,000	3,902,123
5 to 10 per cent	3,066,116	36,793,219	3,444,041	33,349,178	13,188,206	6,084,039	20,160,972
10 to 25 per cent	35,511,673	420,775,605	47,383,206	373,392,399	141,920,612	96,266,471	231,471,787
25 to 50 per cent	6,599,149	193,114,868	23,205,921	169,908,947	67,384,726	26,744,206	102,524,221
Over 50 per cent	1,725,284	62,461,450	7,533,858	54,927,592	21,588,265	1,885,050	33,339,327
Total	47,246,214	720,061,883	82,158,843	637,903,040	246,504,610	131,580,366	391,398,430
Corporations which distributed from 20 to 30 per cent of total net income as cash dividends:							
Less than 5 per cent	1,106,021	10,293,863	393,913	9,899,950	2,828,213	400,000	7,071,737
5 to 10 per cent	2,108,761	25,795,655	2,619,989	23,175,666	6,531,409	2,642,900	16,644,257
10 to 25 per cent	38,543,628	475,280,904	52,564,932	422,695,972	120,226,654	38,252,718	302,469,318
25 to 50 per cent	7,765,316	272,584,694	32,540,918	240,043,776	67,922,495	26,988,874	172,121,281
Over 50 per cent	5,156,728	106,546,062	12,522,998	94,023,064	25,362,341	12,430,900	68,660,723
Total	54,680,454	890,481,178	100,642,750	789,838,428	222,871,112	80,715,392	566,967,316

TABLE 7.—*Taxable and nontaxable income, dividends, and undivided current profits for 1923 of 12,621 corporations with net incomes exceeding $50,000 and which distributed less than 60 per cent of net income as dividends, classified according to per cent of net income distributed as dividends and ratio of net earnings to combined capital, surplus, and undivided profits*—Continued

SHOWING PRIOR-YEAR LOSSES—Continued

Ratio of net earnings for 1923 to combined capital, surplus, and undivided profits expressed in per cent	Total nontaxable income	Total net income	Federal income tax, 1923	Total net income less tax	Dividends paid		Undivided current profits
					Cash	Stock	
Corporations which distributed from 10 to 20 per cent of total net income as cash dividends:							
Less than 5 per cent	$3, 652, 068	$7, 276, 125	$384, 387	$6, 891, 738	$1, 107, 363		$5, 784, 375
5 to 10 per cent	4, 455, 324	36, 639, 518	2, 709, 148	33, 930, 370	5, 106, 324	$5, 940, 425	28, 824, 046
10 to 25 per cent	12, 499, 299	232, 606, 306	26, 702, 112	205, 904, 194	35, 818, 875	31, 177, 274	170, 085, 319
25 to 50 per cent	9, 487, 097	290, 948, 789	34, 704, 834	256, 243, 955	45, 165, 756	62, 067, 981	211, 078, 199
Over 50 per cent	2, 938, 574	71, 312, 049	8, 514, 968	62, 797, 081	10, 357, 644	12, 894, 449	52, 439, 437
Total	33, 032, 362	638, 782, 787	73, 015, 449	565, 767, 338	97, 555, 962	112, 060, 129	468, 211, 376
Corporations which distributed less than 10 per cent of total net income as cash dividends:							
Less than 5 per cent	985, 915	13, 322, 505	220, 110	13, 102, 395	209, 341		12, 893, 054
5 to 10 per cent	7, 113, 622	34, 852, 046	2, 934, 100	31, 917, 946	1, 244, 996	3, 387, 400	30, 672, 950
10 to 25 per cent	5, 420, 708	96, 912, 025	9, 765, 257	87, 146, 768	5, 753, 247	15, 869, 796	81, 393, 521
25 to 50 per cent	6, 887, 189	110, 744, 402	12, 782, 580	97, 961, 822	7, 213, 638	18, 245, 523	90, 748, 184
Over 50 per cent	2, 538, 186	89, 220, 045	10, 662, 871	78, 557, 174	3, 736, 092	14, 791, 225	74, 821, 082
Total	22, 945, 620	345, 051, 023	36, 364, 918	308, 086, 105	18, 157, 314	52, 293, 944	290, 528, 791
Corporations which distributed no cash dividends:							
Less than 5 per cent	8, 375, 744	37, 541, 021	3, 017, 915	34, 523, 106		5, 503, 550	34, 523, 106
5 to 10 per cent	7, 065, 178	104, 582, 611	9, 337, 304	95, 245, 307		4, 993, 836	95, 245, 307
10 to 25 per cent	18, 471, 639	199, 645, 396	20, 154, 351	179, 491, 045		24, 039, 643	179, 491, 045
25 to 50 per cent	8, 644, 408	125, 778, 581	13, 372, 135	112, 406, 446		13, 915, 479	112, 406, 446
Over 50 per cent	10, 358, 069	129, 478, 077	13, 688, 572	115, 789, 505		15, 049, 041	115, 789, 505
Total	52, 915, 058	597, 025, 686	59, 570, 277	537, 455, 409		63, 501, 549	537, 455, 409
Grand total	274, 463, 311	4, 124, 368, 757	456, 802, 274	3, 665, 566, 483	1, 024, 686, 388	506, 647, 274	2, 640, 880, 095

TABLE 8.—*Summary of assets of 12,621 corporations with net incomes exceeding $50,000 and which distributed less than 60 per cent of net income as dividends, classified according to per cent of net income distributed as dividends and ratio of net earnings to combined capital, surplus, and undivided profits*

Ratio of net earnings for 1923 to combined capital, surplus, and undivided profits, expressed in per cent	Number of corporations	Cash		Investments		All other assets		Total assets	
		Beginning of year	End of year	Beginning of year	End of year	Beginning of year	End of year	Beginning of year	End of year
Corporations which distributed from 50 to 60 per cent of total net income as cash dividends:									
Less than 5 per cent	24	$3, 366, 471	$3, 496, 847	$44, 343, 484	$45, 024, 282	$159, 729, 340	$159, 758, 680	$207, 439, 295	$208, 279, 809
5 to 10 per cent	199	61, 931, 114	62, 628, 249	237, 692, 526	246, 620, 931	970, 916, 579	1, 000, 642, 442	1, 270, 540, 219	1, 309, 891, 622
10 to 25 per cent	551	155, 829, 549	157, 140, 961	621, 643, 370	644, 739, 539	2, 680, 721, 529	2, 709, 413, 745	3, 458, 194, 448	3, 511, 294, 245
25 to 50 per cent	204	16, 931, 876	21, 617, 151	42, 865, 708	52, 089, 806	166, 664, 287	188, 036, 498	226, 461, 871	261, 743, 455
Over 50 per cent	91	3, 363, 737	4, 546, 192	3, 261, 194	3, 943, 514	27, 671, 988	32, 261, 050	34, 296, 919	40, 750, 756
Total	1, 069	241, 422, 747	249, 429, 400	949, 806, 282	992, 418, 072	4, 005, 703, 723	4, 090, 112, 415	5, 196, 932, 752	5, 331, 959, 867
Corporations which distributed from 40 to 50 per cent of total net income as cash dividends:									
Less than 5 per cent	28	5, 491, 430	5, 503, 630	35, 368, 115	34, 122, 573	127, 674, 707	135, 234, 331	168, 534, 252	174, 860, 534
5 to 10 per cent	201	64, 730, 234	72, 007, 497	249, 485, 363	288, 752, 111	745, 935, 998	745, 346, 067	1, 060, 151, 595	1, 106, 105, 675
10 to 25 per cent	930	308, 782, 130	316, 847, 772	1, 311, 225, 272	1, 441, 522, 239	2, 846, 642, 794	3, 186, 228, 038	4, 466, 650, 196	4, 944, 598, 049
25 to 50 per cent	282	34, 526, 256	47, 743, 937	90, 694, 997	113, 937, 480	356, 502, 997	388, 963, 222	481, 724, 250	550, 644, 639
Over 50 per cent	143	9, 517, 668	12, 322, 063	21, 490, 227	26, 086, 542	92, 786, 169	123, 401, 759	123, 794, 064	161, 810, 364
Total	1, 584	423, 047, 718	454, 424, 899	1, 708, 263, 974	1, 904, 420, 945	4, 169, 542, 665	4, 579, 173, 417	6, 300, 854, 357	6, 998, 019, 261
Corporations which distributed from 30 to 40 per cent of total net income as cash dividends:									
Less than 5 per cent	32	6, 008, 386	7, 046, 327	16, 159, 728	16, 545, 797	247, 357, 029	251, 325, 468	269, 525, 143	274, 917, 592
5 to 10 per cent	171	39, 429, 107	38, 428, 749	141, 258, 893	145, 870, 782	602, 061, 534	628, 126, 456	782, 749, 534	812, 425, 987
10 to 25 per cent	1, 064	319, 518, 540	331, 028, 523	1, 218, 278, 249	1, 324, 414, 851	3, 349, 487, 154	3, 632, 050, 575	4, 887, 283, 943	5, 287, 493, 949
25 to 50 per cent	438	69, 564, 142	83, 785, 913	112, 977, 791	137, 109, 800	619, 240, 993	709, 052, 103	801, 782, 926	929, 947, 816
Over 50 per cent	157	14, 368, 896	19, 750, 663	26, 625, 899	46, 536, 831	172, 776, 058	201, 585, 215	213, 770, 853	267, 872, 709
Total	1, 862	448, 889, 071	480, 040, 175	1, 515, 300, 560	1, 670, 478, 061	4, 990, 922, 768	5, 422, 139, 817	6, 955, 112, 399	7, 572, 658, 053

TABLE 8.—*Summary of assets of 12,621 corporations with net incomes exceeding $50,000 and which distributed less than 60 per cent of net income as dividends, classified according to per cent of net income distributed as dividends and ratio of net earnings to combined capital, surplus, and undivided profits*—Continued

Ratio of net earnings for 1923 to combined capital, surplus, and undivided profits, expressed in per cent	Number of corporations	Cash		Investments		All other assets		Total assets	
		Beginning of year	End of year	Beginning of year	End of year	Beginning of year	End of year	Beginning of year	End of year
Corporations which distributed from 20 to 30 per cent of total net income as cash dividends:									
Less than 5 per cent	22	$8, 114, 913	$9, 242, 004	$21, 268, 576	$26, 163, 788	$315, 616, 017	$321, 307, 975	$344, 999, 506	$356, 713, 767
5 to 10 per cent	121	25, 314, 652	27, 308, 337	81, 552, 353	86, 470, 335	457, 111, 800	477, 551, 957	563, 978, 805	591, 330, 629
10 to 25 per cent	951	330, 300, 752	335, 719, 290	1, 122, 619, 770	1, 218, 905, 295	3, 421, 124, 262	3, 625, 617, 701	4, 874, 044, 784	5, 180, 242, 286
25 to 50 per cent	612	103, 880, 754	117, 672, 442	223, 787, 095	274, 281, 346	1, 110, 666, 117	1, 208, 902, 823	1, 438, 333, 966	1, 600, 856, 611
Over 50 per cent	216	20, 842, 635	26, 591, 944	22, 265, 531	80, 749, 692	228, 792, 577	284, 676, 059	271, 900, 743	392, 017, 695
Total	1, 922	488, 453, 706	516, 534, 017	1, 471, 493, 325	1, 686, 570, 456	5, 533, 310, 773	5, 918, 005, 515	7, 493, 257, 804	8, 121, 160, 988
Corporations which distributed from 10 per cent to 20 per cent of total net income as cash dividends:									
Less than 5 per cent	19	4, 662, 396	3, 984, 045	122, 679, 253	123, 615, 422	234, 808, 170	244, 325, 241	362, 149, 819	371, 924, 708
5 to 10 per cent	117	18, 596, 787	25, 037, 627	60, 632, 192	73, 726, 810	577, 393, 187	604, 035, 053	656, 622, 166	702, 799, 490
10 to 25 per cent	636	121, 032, 382	133, 075, 030	296, 644, 408	339, 086, 298	1, 551, 035, 740	1, 736, 442, 138	1, 968, 712, 530	2, 308, 603, 466
25 to 50 per cent	754	94, 646, 437	121, 556, 749	225, 422, 001	293, 691, 873	1, 070, 526, 562	1, 279, 636, 549	1, 390, 585, 000	1, 694, 865, 171
Over 50 per cent	268	18, 195, 900	28, 530, 282	32, 036, 328	40, 998, 448	197, 951, 014	234, 952, 083	245, 183, 242	304, 480, 813
Total	1, 794	257, 133, 902	312, 183, 733	737, 414, 182	871, 118, 851	3, 631, 714, 673	4, 099, 391, 064	4, 626, 262, 757	5, 282, 693, 648
Corporations which distributed less than 10 per cent of total net income as cash dividends:									
Less than 5 per cent	14	21, 175, 666	22, 412, 503	282, 955, 908	287, 047, 302	917, 034, 283	893, 999, 232	1, 221, 165, 857	1, 203, 459, 037
5 to 10 per cent	63	30, 529, 566	28, 648, 795	91, 915, 710	98, 027, 288	1, 094, 599, 657	1, 158, 525, 754	1, 217, 044, 933	1, 285, 201, 837
10 to 25 per cent	279	49, 423, 511	44, 284, 322	93, 789, 977	113, 569, 254	793, 576, 383	849, 761, 454	936, 789, 571	1, 007, 615, 030
25 to 50 per cent	358	28, 868, 809	40, 395, 268	114, 939, 911	119, 664, 655	398, 815, 673	485, 901, 725	542, 624, 393	645, 961, 648
Over 50 per cent	280	17, 854, 100	27, 829, 218	38, 303, 898	52, 041, 061	212, 55 0, 924	270, 520, 092	268, 768, 922	350, 390, 371
Total	992	147, 851, 652	163, 570, 106	621, 965, 404	670, 349, 60	53, 416576. 920	3, 658, 708, 257	4, 156, 393, 976	4, 492, 627, 923

Corporations which distributed no cash dividends:									
Less than 5 per cent	194	53, 618, 542	52, 604, 638	301, 857, 352	289, 298, 866	1, 748, 747, 020	1, 772, 618, 868	2, 104, 222, 914	2, 114, 522, 312
5 to 10 per cent	415	82, 123, 140	84, 797, 278	291, 327, 283	309, 340, 321	3, 007, 273, 507	3, 029, 918, 857	3, 380, 723, 930	3, 424, 056, 456
10 to 25 per cent	1, 155	108, 312, 747	123, 170, 927	292, 047, 096	333, 945, 470	1, 688, 275, 075	1, 853, 194, 907	2, 068, 634, 918	2, 310, 310, 404
25 to 50 per cent	849	37, 734, 965	48, 504, 705	80, 363, 374	113, 977, 614	581, 814, 086	682, 509, [illegible]	699, 912, 425	844, 992, 199
Over 50 per cent	785	35, 097, 621	50, 128, 252	93, 301, 921	128, 209, 573	458, 458, 097	556, 825, [illegible]	586, 857, 639	735, 163, 821
Total	3, 398	316, 887, 015	359, 205, 800	1, 058, 897, 026	1, 174, 771, 844	7, 484, 567, 785	7, 895, 077, 548	8, 860, 351, 826	9, 429, 045, 192
Grand total	12, 621	2, 323, 685, 811	2, 535, 388, 130	8, 063, 140, 753	8, 970, 127, 789	33, 232, 339, 307	35, 662, 649, 033	43, 619, 165, 871	47, 168, 164, 952

TABLE 9.—*Computation of surtax at 1926 rates on undivided 1923 profits of corporations reporting income exceeding $50,000 and which distributed less than 60 per cent of net earnings as cash dividends*

	Undistributed earnings allocated to taxpayer	Per cent to total undistributed earnings	Distribution of undivided profits of corporations reporting income over $50,000 and which distributed less than 60 per cent of net earnings as cash dividends	Surtax rate, per cent	Surtax on undistributed earnings
Under $10,000	$2,707,836	3.159	$83,317,170		
$10,000-$14,000	2,190,189	2.479	65,382,490	1	$653,825
$14,000-$16,000	1,208,362	1.364	35,974,876	2	719,498
$16,000-$18,000	1,256,640	1.419	37,425,475	3	1,122,764
$18,000-$20,000	1,310,602	1.480	39,192,570	4	1,567,703
$20,000-$22,000	1,377,620	1.555	41,012,413	5	2,050,621
$22,000-$24,000	1,430,664	1.615	42,594,886	6	2,555,693
$24,000-$26,000	1,427,488	1.612	42,515,762	7	2,976,103
$26,000-$28,000	1,437,313	1.623	42,805,882	8	3,424,471
$28,000-$30,000	1,434,342	1.619	42,700,384	9	3,843,035
$30,000-$34,000	2,829,191	3.194	84,240,288	10	8,424,029
$34,000-$36,000	1,402,615	1.584	41,777,275	11	4,595,500
$36,000-$38,000	1,389,555	1.569	41,381,657	12	4,965,799
$38,000-$42,000	2,714,711	3.065	80,837,972	13	10,508,936
$42,000-$46,000	2,640,720	2.988	78,807,132	14	11,032,998
$46,000-$50,000	2,618,549	2.956	77,963,147	15	11,694,472
$50,000-$60,000	6,215,442	7.017	185,070,163	16	29,611,226
$60,000-$70,000	5,508,818	6.219	164,023,278	17	27,883,957
$70,000-$80,000	4,853,861	5.480	144,532,491	18	26,015,848
$80,000-$100,000	8,210,724	9.270	244,492,007	19	46,453,481
$100,000 and over	34,302,973	38.727	1,021,406,898	20	204,281,380
Total	88,576,215	100.000	2,637,464,225	[1] 15.332	404,381,339

[1] Average.

The table facing this page is a summary of individual incomes and deductions for the period 1916 to 1924, inclusive. These figures are taken from the "Statistics of income" published each year by the Bureau of Internal Revenue.

JAMES COUZENS.
A. A. JONES.
WILLIAM H. KING.

OVERSIZE PAGE

At this place in the printed edition of this volume there is an oversize page. It and all other similar pages in the collection are to be found under the heading:

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GREENWOOD PUBLISHING CORPORATION, WESTPORT, CONNECTICUT

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APPENDIX

SENATE COMMITTEE INVESTIGATING
BUREAU OF INTERNAL REVENUE,
Washington, D. C., February 1, 1926.

To: Senator Couzens.
From: L. C. Manson, Counsel.
Subject: Amortization.

The following consists of brief reports on allowances for the amortization of war facilities, prepared by Mr. L. H. Parker, chief engineer of the committee. These reports are the basis of the discussion of this subject in the partial report, which has been made on this subject by the committee to the Senate.

Respectfully submitted.

L. C. MANSON, *Counsel.*

MISCELLANEOUS

Name: Acheson Graphite Co., Buffalo, N. Y.
Business: Manufacture of graphitized electrodes, graphite powder, and graphite lubricant.
Original amount claimed: $394,480.46.
Final amount claimed: $699,065.89.
Amount finally allowed: $577,282.88.
Date of last determination: May 3, 1922.
Amortization deducted on property discarded or sold: $577,282.88.
Basis of last determination: Salvage value of retained facilities.
Amount based on solicitor's ruling and on sound engineering principles ;577,282.88.
NOTE.—The above allowance is not questioned.

Name: Air Reduction Co., New York, N. Y.
Business: Manufacture of oxygen and acetylene gas.
Original amount claimed: $541,839.96.
Final amount claimed: $1,126,658.95.
Amount finally allowed: $887,098.64.
Date of last determination: September 24, 1924.
Amortization deducted on property discarded or sold: None.
Amortization deducted on reduced replacement costs: $533,623.18.
Amortization deducted on value in use: $353,475.46.
Basis of last determination: Ratio of average annual production for 1920 to 923 (inclusive) to rated capacity during war period.
Amount based on solicitor's ruling and on sound engineering principles: 533,623.18.
Amount not based on sound engineering principles and not specifically conemned by solicitor's ruling: $353,475. 46.

NOTE.—This taxpayer was engaged in the manufacture and distribution of cetylene gas and oxygen and operated 11 plants throughout the United States. its 1918 tax returns amortization was claimed in the sum of $598,996.52. ubsequently, a revised claim was submitted in the sum of $1,126,568.95. Engineer Diemer submitted a report covering this claim, in which it was recomended taxpayer be allowed $841,248.03 as amortization. Taxpayer took exeption to this allowance and subsequently or after a conference between repreentatives of the unit and taxpayer, Engineer H. J. Ord submitted a report on a edetermination of the claim and recommended an allowance of $887,098.64, or n increase of $45,850.61 over the former allowance. This increase was the esult of the action of the conference above mentioned. Engineer Ord did not in any way change the basis upon which Engineer Diemer computed allowable amortization but used same in his determination.

Amortization has been computed on two bases: Reduced replacement costs and postwar value in use. This postwar utility value is arrived at by comparing the average production, days operated, and power consumed of each plant for the years 1920, 1921, 1922, and 1923 with normal war-time capacity. This is a new departure from the regular method of handling such cases in the unit. Ordinarily, postwar production is computed on the basis of the average production of the years 1921, 1922, and 1923, the years 1919 and 1920 being almost invariably omitted. Therefore it would seem that once again an arbitrary method has been used by the engineer in computing amortization.

As an illustration of the unsoundness of using the ratio of the average production of the postwar years to war-time capacity, in computing amortization, the production figures in this case show that in 1923 the production of the Buffalo plant was 15,120,000 cubic feet as against a rated war-time capacity of 15,120,000 of the same plant, or 100 per cent. The production of the Chicago plant for 1923 was 32,087,030 cubic feet as compared with a rated capacity of 30,240,000 cubic feet. The production at this plant in 1920 was 29,620,665 cubic feet against 28,645,000 cubic feet capacity. At the Minneapolis plant 1923 production was 100 per cent of rated capacity. At the Philadelphia plant 1923 production was 100.6 per cent of rated capacity. At the Richmond plant 1923 production was 99.6 per cent of rated capacity. At the Seattle plant 1923 production was 99.7 per cent of rated capacity.

The following is a tabulation of the above:

Plant	Year	Rated war-time capacity (cubic feet)	Production	Production, per cent of rated capacity	Per cent used by engineer
Buffalo	1923	15,120,000	15,120,000	100	94.5
Chicago	1920	28,645,000	29,620,665	103.4	90.1
Do	1923	30,240,000	32,087,030	106.1	90.1
Minneapolis	1923	15,120,000	15,120,000	100	85.0
Philadelphia	1923	57,120,000	57,489,800	100.6	79.5
Richmond	1923	16,800,000	16,737,080	99.6	86.5
Seattle	1923	16,800,000	16,750,125	99.7	88.4

From the above it will be seen that in 1923 the actual production of 7 of the 10 plants was either approximately equal to or greater than the rated war-time capacity, and in 1920 the production of the Chicago plant was 103.4 per cent of the rated capacity, whereas the engineer has, by averaging the production of the postwar years, arrived at a much lower percentage upon which he bases amortization.

If we average the above production, capacity, and percentage figures, we find that the average production was 101.3 per cent of capacity of the seven plants. Further, we find that the average percentage as used by the engineer is 86.4 per cent, or 14.9 per cent lower than the average rated war-time capacity. This would mean that if the theory upon which the engineer bases his computations is correct, taxpayer could not have produced its 1923 output without having its facilities 100 per cent in use, which would have precluded the allowance of any amortization.

The following points should be especially noted:

1. The plant and facilities of this taxpayer were not special equipment, but were absolutely adapted to ordinary commercial use and were returned to practically full use before the end of the amortization period, March 3, 1924. We believe all amortization based on reduced values in use should be disallowed.

2. The original claim of the taxpayer was only about 60 per cent of the final allowance by the bureau.

3. The value in use is based on the ratio of average postwar production in 1920, 1921, 1922, and 1923 to the war capacity.

4. The value in use has not been determined from the examination of the special facilities but simply on each of the 11 plants as a whole.

5. There is no mention of any investigation on the part of the bureau's engineer to determine whether or not the taxpayer had purchased in the postwar period facilities similar to those installed during the war, thus furnishing proof

of the taxpayer's need of his war facilities. This in spite of the fact that the determination was finally made in September, 1924, or 11 months after the solicitor's ruling on this point had been made.

6. No consideration is given to the salvage value of the facilities amortized on the value in use basis.

7. No consideration is given to the matter of determining whether or not the facilities installed were replacements or additional equipment.

8. Value in use percentage applied to depreciated postwar replacement cost.

SHIPBUILDING

Name: Alabama Dry Dock & Ship Building Co.
Business: Shipbuilding and ship repair work.
Original amount claimed: Not determined.
Final amount claimed: $540,616.77.
Amount finally allowed: $508,943.41.
Date of last determination: April 14, 1921.
Amortization deducted on property discarded or sold: $439,543.28.
Amortization deducted on value in use: $69,400.13.
Basis of last determination: Arbitrary estimate of value in use of facilities of 45 per cent.
Amount based on solicitor's ruling and on sound engineering principles: $439,543.28.
Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $69,400.13.

NOTE.—The following general points should be noted in respect to this allowance:

(1) The taxpayer prior to the war was engaged in ship repair work. This business was continued during the war and in addition taxpayer increased his facilities to construct two Ferris type wooden steamships and two 7,500-ton steel coal barges. It is obvious that a large portion of these expenditures were of very little value after the war, especially those installed for wooden ship construction.

The taxpayer has four small plants, and the engineer has made detailed schedules of all property and assigned an individual value to each item. As this report is dated April 6, 1921, it would seem that originally it was intended to examine individual items, as required later by solicitor's memorandum of August, 1923.

While the name of this taxpayer indicates he is in the dry-dock business, amortization on dry docks themselves is not involved. One dry dock was built before the war and the one built during the war was paid for directly by the Emergency Fleet Corporation.

(2) The original claim is about 8 per cent greater than the amount finally allowed.

(3) The value in use percentage is practically a direct estimate of the examining engineer; 45 per cent is used in most cases. However, it is varied on some items and is probably as accurate as in most cases.

(4) The specific facilities of taxpayer have evidently been examined.

(5) There appears to be no probability of postwar expenditures at these plants.

(6) Proper account is not taken of salvage value in determining value in use.

(7) No investigation is made in order to determine whether war expenditures were in the nature of replacements or additions.

(8) Value in use percentages have been applied to war cost less 1917 depreciation.

GENERAL NOTE.—While we do not question the major portion of this amortization allowance, which amounts to $439,543.28, we do consider the amount allowed on value in use amounting to $69,400.13 questionable for reasons we shall state hereafter, although such allowance was not specifically condemned by solicitor's ruling of August, 1923. This is a small and unimportant case, and we do not think as a whole taxpayer received too much amortization, but we wish to discuss certain principles which are exemplified in this allowance.

In the first place, it should be kept in mind that at the date of this report the taxpayer was continuing his pre-war business of repairing ships. He was allowed full opportunity to discard all those war facilities which he could not use, and could select just those facilities which he desired to retain in his postwar business.

Now, the taxpayer had two 48-inch Whiting punches, purchased during the war, and also one 36-inch Whiting punch. He elected to discard one 48-inch punch and the 36-inch punch, keeping in use one of the 48-inch punches.

It appears probable that he discarded the 36-inch punch because, of course, certain work, even though very seldom called for, can not be done on a 36-inch punch that can be done on a 48-inch punch. On the other hand, a 48-inch punch can do the work of a 36-inch punch, even though a little inconvenience is met with.

Now, the engineer determines the sale or salvage value of a 48-inch punch to be 40 per cent of cost. He also determines that the 48-inch punch retained is 45 per cent in use. The installation costs of the two punches vary slightly on account of installation expense, so we will use the average cost of $3,500 each for both punches for purposes of discussion.

Then we will have in case of discarded 48-inch punch the following computation:

Cost	$3,500
Salvage value, 40 per cent	1,400
Residual value to taxpayer	2,100

Then we will also have in case of a similar 48-inch punch retained in use the following computation:

Cost	$3,500
Value in use, 45 per cent	1,575
Residual value to taxpayer	1,925

Then this punch which is retained in use by the taxpayer is only worth $175 more to him in his going business than the one that is absolutely discarded.

Moreover, how can the taxpayer get along in his business without the punch, he has discarded all but one, and he don't need half a punch or 45 per cent of a punch, but a whole punch. Furthermore, the fact that he has discarded a 36-inch punch shows that he can not get along with one of smaller size.

It would seem in such cases that the real loss to the taxpayer is the difference between war cost and postwar replacement value.

The following items are also noted:

(*a*) Two 2-ton hoists 45 per cent in use. Why could not the taxpayer sell one and keep the other in full use?

(*b*) Two 20-inch Champion drill presses 45 per cent in use. Why could not the taxpayer sell one and keep the other in full use?

(*c*) Two 19 by 10 Sydney lathes 45 per cent in use. It is obvious one could be discarded if each is only 45 per cent in use.

In conclusion, we believe that the shipbuilding industry is entitled to as great or greater consideration in regard to amortization, than any other as of March 3, 1924. However, if a taxpayer, as in this case, has full chance to discard all unnecessary equipment and receive amortization thereon of $439,500, it is doubtful if he should receive the further allowance of $69,000 on items absolutely necessary to his going business on the basis of lowered value in use. The loss on such items we believe should be confined to the lowered replacement cost basis.

IRON AND STEEL

Name: Alan Wood, Iron & Steel Co., Philadelphia, Pa.

Business: Production of pig iron, ingots, etc.

Original amount claimed: $566,185.50.

Final amount claimed: $2,817,232.05.

Amount finally allowed: $2,091,893.63.

Date of last determination: November 14, 1921.

Amortization deducted on property discarded or sold: $30,995.11.

Amortization deducted on value in use: $2,060,898.52.

Basis of last determination: Ratio of war-time production of postwar production.

Amount based on solicitor's ruling and on sound engineering principles: $30,995.11.

Amount not based on solicitor's ruling.

Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $2,060,898.52.

NOTE.—The following points are of interest in this allowance:

(1) The business of the taxpayer consists of the manufacture of foundry and basic pig iron, ingots, billets, plates, and sheets. The facilities on which amortiza-

tion is allowed include a 550-ton blast furnace and complete auxiliary equipment, sinter plant, open-hearth furnaces, electric power-house equipment, etc. Practically all facilities are retained in use. The value in use determination was made in November, 1921, during an extremely low period in steel production. Taking into account the wording of the law we believe the commissioner should have ordered this amortization allowance redetermined as of March 3, 1924, in view of the great increase in the steel business in 1923.

(2) The original claim was only about 25 per cent of the amount finally allowed.

(3) The value in use percentage is obtained from the ratio of average postwar production in 1919, 1920, and 1921 (10 months) to war capacity (based on actual production). In the case of blast furnace and auxiliary equipment which comprises the greater part of this allowance, the value in use percentage is 57 per cent. This is arrived at as follows:

Blast furnace	Rated capacity (tons daily)	Capacity based on actual production	Production January, 1919, to October, 1921
No. 1	325	643.09	341.4
No. 2	475		279.4
No. 3	550	430.23	
Total		1,073.32	612.8

$$\text{Value in use} = \frac{612.8}{1{,}073.32} = 57 \text{ per cent.}$$

The record does not disclose the age of blast furnaces Nos. 1 and 2 other than to call them "old" furnaces. We also know that both these furnaces were in operation as far back as 1912. It is evident that by averaging the three furnaces together, equal value is given to the old furnaces as to the new, up-to-date furnace. Further, it is well established, that the 550-ton furnace is much more economical in operation than a 325-ton furnace.

(4) The specific facilities of taxpayer appear to have been examined.

(5) Certain additions made during the postwar period are mentioned as being the grounds on which amortization is disallowed on facilities of a similar nature installed during the war.

(6) No allowance is made for the salvage value of items in determining value in use.

(7) No investigation is made to determine whether war expenditures were for replacements or additions.

(8) The value in use percentage is applied to war cost less 1917 depreciation

Name: Allegheny Steel Co., Pittsburgh, Pa.
Business: Steel products.
Original amount claimed: $201,375.94.
Final amount claimed: $718,701.10.
Amount finally allowed: $519,970.57.
Date of last determination: January 22, 1921.
Amortization deducted on property discarded or sold: $242,323.80.
Amortization deducted on value in use: $277,646.77.

Basis of last determination: Use to which facilities were put during postwar period as compared with use of same during war period. Also arbitrary allowances.

Amount based on solicitor's ruling and on sound engineering principles: $242,323.80.

Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $277,646.77.

NOTE.—The following points should be noted in connection with this case:

(1) The facilities amortized are gas producers, tube mill and plate mill, and brass cartridge plant.

(2) The original amount of amortization claimed was less than 40 per cent of the amount finally allowed.

(3) Value in use of facilities is, in general, determined by the ratio of postwar production as at date of examination to normal war capacity. The per cent in use varies from 50 to 73.7 per cent.

(4) The specific facilities of taxpayer have been examined in some cases, and in some cases facilities have been grouped by departments.

(5) No record of an investigation as to extent and nature of postwar purchases appears.

(6) Salvage value is not shown in determining value in use.

(7) No investigation is made as to whether the war expenditures were for replacements or additions.

(8) Value-in-use percentage is applied to depreciated war cost.

(9) Forty-five thousand dollars allowance made on land.

MACHINERY MANUFACTURES

Name: Allis-Chalmers Manufacturing Co., Milwaukee, Wis.

Business: Manufacture of shells, steam turbine, marine engines, propeller shafts, gun slides, and other similar equipment.

Original amount claimed: $598,908.61.

Final amount claimed: $1,573,171.59.

Amount finally allowed: $1,001,438.71.

Date of last determination: January 28, 1924.

Amortization deducted on property discarded or sold: $141,641.09.

Amortization deducted on value in use: $859,797.62.

Basis of last determination: Production and labor basis.

Amount based on solicitor's ruling and on sound engineering principles: $141,641.09.

Amount not based on solicitor's ruling: $859,797.62.

Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: None.

NOTE.—The record in this case discloses the fact that the original deduction of $598,908.61 made by taxpayer on its 1918 and 1919 returns was passed upon by the unit's auditor without first having been investigated by the engineering division. The auditor made a tentative allowance in the sum of $417,089.59. It was upon this basis that the taxpayer's income tax was computed and paid.

Subsequently, and against the urgent request of the taxpayer, the case was reopened and an allowance of $1,001,438.71 was made. It further appears that this taxpayer did a great amount of work for Government departments under Government contracts. An examination of the files of the Navy Department discloses that a large sum was paid this taxpayer for certain facilities. There is nothing in the record to show that a check has been made on the payments made by the Navy Department as against the allowances made by the Income Tax Unit. The engineer merely stating, "Taxpayer states that no contractual amortization was received on any of its facilities that are listed in its claim for amortization * * *."

Thus it would seem that the taxpayer's say so in this matter was accepted without investigation, even though it was known that it had received amortization from at least one Government department.

The engineer who investigated this case freely admits that the facilities upon which amortization was allowed were treated in groups as much as possible. This is in direct opposition to the solicitor's ruling and yet it was approved by a reviewing engineer of the unit and by the chief of section.

Further, the engineer took as a basis of computing amortization the average production and labor hours of "postwar" years, which average was estimated when actual figures were available and even states in his report that postwar capital expenditures at one plant were nearly as great as war-time expenditures; also that a large portion of war construction on buildings were on lines of permanent improvements and that war equipment installed "consisted largely of replacements and betterments." In the face of the above he made an allowance of 25 per cent of the depreciated costs of same.

The following points should be especially noted:

1. The taxpayer is in the general machinery business and he has two plants on which amortization is allowed.

The West Allis (Wis.) plant is "the third largest plant of its kind in the United States. The plant contains, in addition to its machine shops, erecting floors, etc., well-equipped gray iron, malleable iron, and brass foundries; also forge shops, boiler and blacksmith shops * * *."

In fact, the West Allis plant is equipped to produce nearly all kinds of power machinery, such as steam turbines, steam engines, gas and oil engines, generators, motors, transformers, switchboards, etc.

Most of the machinery produced by taxpayer contributed directly or indirectly to the prosecution of the war, but "taxpayer states that practically all equipment purchased specifically for the shell contracts was amortized over the life of the same and was not capitalized and is not listed in its claim for amortization."

For the reason "taxpayer states that no contractual amortization was received on any of its facilities listed in its claim for amortization. A large, heavy constructed building erected specially for tempering propeller shafts for the United States Navy is not included in facilities listed in the claim."

A large part of taxpayer's war work outside of that noted above was the production of steam turbines, marine engines, and gun mounts. It also produced a large amount of its standard product, such as pumps, gas engines, electric and the hydraulic equipment for direct war use.

The other plant of the taxpayer, located at Norwood, Ohio, is engaged principally in manufacturing standard electrical equipment.

To sum up, we conclude that a very large portion of the taxpayer's facilities on which amortization was allowed consisted of standard equipment on which no ultimate loss was sustained as of March 1, 1924. A somewhat premature investment was made through war expenditures. We believe that all facilities retained in use must have been adaptable to the taxpayer's business, and the records show his 1923 business was sufficiently good to require the use of such facilities. The special facilities used only in the manufacture of special war equipment were taken care of under the heading of "Property discarded and sold." This allowance we are not questioning.

2. The original amount of amortization claimed was only about 60 per cent of the amount finally allowed.

3. The value in use of facilities is either based on the ratio of actual postwar pay roll for the years 1921, 1922, and 1923 (estimated) to normal pay roll with plant in full operation, or on the ratio of average postwar production for 1921, 1922, and 1923 (estimated) to war capacity.

4. The value in use has not been determined from an examination of the specific facilities but by grouping such facilities, for example, as follows:

Group A.—Machinery for production of hydraulic turbines, centrifugal pumps, steam pumps, blowing engines, steam engines, air compressors, condensers, hoists, etc.

Group B.—Machinery for production of steam turbines, gas and oil engines.

Group C.—Machinery for production of generators, motors, condensers, transformers, etc.

On the entire plant at Norwood, Ohio, one ratio of value in use is applied to all the amortizable facilities.

5. While the record does not show that any proper investigation was made to determine whether or not post-war facilities were installed similar to the war facilities, which would furnish evidence of the need of the war facilities as ruled by the solicitor, it does show that on at least one plant the postwar capital expenditures were nearly as great as war expenditures and also that a large portion of war construction on buildings was in the line of permanent improvements and that war equipment installed "consisted largely of replacements and betterments."

6. No reduction is made in the allowance for value in use on account of the salvage value of these facilities.

7. No reduction is made in the allowance for value in use on account of the facilities installed being replacements.

8. The value in use percentage has been applied to war costs less 1917 depreciation.

ALUMINUM PRODUCTS

Name: Aluminum Co. of America, Pittsburgh, Pa.

Business: Manufacture of aluminum products.

Original amount claimed: $6,852,697.36.

Final amount claimed: $18,268,435.82.

Final amount allowed: $15,589,614.39.

Date of last determination: June, 1923.

Amortization deducted on value in use: $15,589,614.39.

Basis of last determination: Ratio of war-time capacity to average postwar production.

Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $15,589,614.39.

This case has been fully discussed in the hearing before the committee.

MUNITIONS

Name: American Clay Machinery Co., Bucyrus, Ohio.
Business: Manufacture of shells, special equipment for shells, etc.
Original amount claimed: $670,953.65.
Final amount claimed: $1,565,936.14.
Amount finally allowed: $1,365,335.65.
Date of last determination: May 7, 1925.
Amortization deducted on property discarded or sold: $1,054,373.63.
Amortization deducted on value in use: $310,962.02.
Basis of last determination: Estimated residual values based on taxpayer's claim, also, taxpayer's estimate of value in use ratio, also taxpayer's estimate of ratio of war-time number of employees to postwar number.
Amount based on solicitor's ruling and on sound engineering principles: $1,054,373.63.
Amount not based on solicitor's ruling: $310,962.02.

NOTE.—The following points should be noted in connection with this allowance:

(1) The American Clay Machinery Co. (Hadfield-Penfield Steel Co., successor) and its subsidiary, the American Steel & Machinery Co., were originally manufacturers of clay machinery. Prior to our entrance into the war they made shells for European governments, and after our entry into the war they made shells for our Government and increased their plant. They also made windlasses, capstans, winches, engines, etc., for the United States Shipping Board.

The taxpayer companies have four plants. The plant at Mansfield was entirely for the manufacture of shells and amortization, being based on the discarded value of the plant, the allowance is not questioned.

The South Bucyrus plant was originally designed to provide special steel for the Mansfield plant. Since the war, however, it has been possible to utilize a portion of this plant for the manufacture of manganese steel castings. This is an excellent case of the conversion of a war industry to a profitable peace-time industry and we will therefore show production figures in full, as follows:

Production—Foundry—South Bucyrus

Year	Carbon steel	Gray iron	Manganese steel	Total
	Pounds	*Pounds*	*Pounds*	*Pounds*
1919	781,247	4,860,257	0	5,641,504
1920	727,788	7,196,741	0	7,924,529
1921	180,989	3,219,466	11,424	3,411,879
1922	463,019	3,501,605	1,722,299	5,686,923
1923	82,957	3,356,314	2,325,992	5,715,263
1924	155,612	1,537,101	3,011,637	3,500,249
January, 1925	163,800	0	490,322	
February, 1925	166,700	0	474,529	
Production for 1925 if continued at same rate as in January and February	1,983,000	0	5,789,106	7,789,106

The taxpayer's war work did not entirely cease on Government contracts until the spring of 1923. There appears to be no discarded items at this plant. The engineer allows a value of 65 per cent in use. It is quite obvious from indications of the production in 1925 of 7,789,106 pounds against 7,924,529 pounds in 1920 (the peak war production) that the taxpayer has suffered no ultimate loss on the facilities installed at this plant.

The Bucyrus plant of the taxpayer is the third to be considered. During the war this plant was engaged in making marine machinery and shells. After the war this plant was adapted to the manufacture of clay machinery, Diesel engines, tractors, stokers, and road machinery. The analysis of sales by years at this plant is interesting.

Sales by years—Bucyrus plant

Year	Commercial	War work and munitions	Total
1916	$349,047.74	$528,286.60	$877,334.34
1917	558,284.04	1,145,358.47	1,703,642.51
1918	367,889.15	1,472,901.53	1,840,790.68
1919	414,233.22	1,680,540.60	2,094,773.82
1920	994,003.51	91,967.66	1,085,971.17
1921	783,432.26	4,189.14	787,621.40
1922	906,941.60	5,880.00	912,821.60
1923	1,175,071.60	1,362.50	1,176,433.67

Considering the fact that during the war two shifts instead of one were employed, it is obvious from the above figures that the taxpayer has had nearly full use of items retained from his war plant. We have not questioned the allowance made at this plant on discarded facilities, but we do consider that the taxpayer has suffered no ultimate loss on those facilities retained in use.

The fourth plant of the taxpayer is known as the Willoughby plant. The war work performed at this plant consisted principally of marine machinery for the Shipping Board. After the war the plant was used in the manufacture of clay machinery, tractors, and other equipment similar to that manufactured at the Bucyrus plant. The value in use at this plant is taken at 50 per cent based on man-hours.

Both the man-hour and production figures are deceptive when applied to use of a plant working on items of different character and weight. We have not questioned the allowance on discarded items, but the condition of business in 1923 was sufficient to show at this plant that on facilities retained in use taxpayer suffered little ultimate loss.

(2) The original amount of amortization claimed by this taxpayer was only 50 per cent of the amount finally allowed.

(3) Value in use, as described above, was based on two different systems:

1. Ratio of average postwar production in tons for 1921, 1922, and 1923 to peak war production.

2. Ratio of average number of employees or man-hours in 1921, 1922, and 1923 to number of employees in 1918.

Considering 1923, 1924, and 1925, very little if any ultimate loss is shown in our opinion on items retained in use.

(4) Amortization has not been determined as to specific facilities as required by the solicitor's ruling published prior to the final report in this case but as to whole plants.

(5) No mention is made as to whether the taxpayer purchased in postwar years facilities which were of a nature similar to those purchased during the war, although the solicitor's ruling above mentioned required this.

(6) Proper allowance is not made for salvage value in determining value in use.

(7) No investigation was made of the war expenditures to determine whether they were in the nature of replacements or additions.

(8) Value in use percentage is applied to war cost less 1917 depreciation.

MACHINERY MANUFACTURES

Name: American Locomotive Co., Bethlehem, Pa.
Business: Manufacture of locomotives.
Original amount claimed: $816,488.86.
Final amount claimed: $2,834,896.90.
Amount finally allowed, $1,714,403.18.
Date of last determination: April 20, 1923.
Amortization deducted on property discarded or sold: $484,709.81.
Amortization deducted on reduced replacement costs: $160,670.61.
Amortization deducted on value in use: $1,069,022.76.
Basis of last determination: Ratio wartime capacity to postwar production.
Amount based on solicitor's ruling and on sound engineering principles: $645,380.42.
Amount not based on solicitor's ruling: $1,069,022.76.
Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: None.

The following points should be noted in respect to this allowance:

(1) The general nature of the facilities used in this taxpayer's business are those necessary for the complete manufacture of steam locomotives. The facilities of the taxpayer were all normal to his regular business with the exception of those items discarded or sold, amortization on which is not questioned.

(2) The original claim of taxpayer was less than one-half of the amount finally allowed, and was disallowed entirely on the first engineer's examination.

(3) The basis of the determination of value in use, which is the only portion of the amortization allowance questioned, is the ratio of normal capacity to postwar production for 1921, 1922, and 1923 estimated. The production in 1921 and 1922 was distinctly subnormal. In regard to 1923 the bureau's engineer states: "The expected business for 1923 * * * as shown by unfilled orders on the taxpayer's books * * * indicated that all of the taxpayer's plants would be required to operate at very nearly if not their full capacity during the

entire year." It is the opinion of your engineers that there was no ultimate loss to the taxpayer on the basis of value in use as of March 3, 1924.

(4) The specific facilities of the taxpayer have not been examined, but the value in use has been assigned to each of the different plants of the taxpayer as a whole, which is contrary to solicitor's ruling of August 19, 1923.

(5) No investigation has been made to determine whether or not expenditures for machinery in the postwar period proved the full useful value of the facilities installed during the war.

(6) No consideration has been given to the salvage value of the facilities in determining the deduction for value in use.

(7) No consideration has been given to the matter of determining whether or not the war facilities were in the nature of replacement or in the nature of additions.

(8) The value in use per cent has been applied to war cost less 1917 depreciation.

MISCELLANEOUS

Name of taxpayer: American Manufacturing Co., Brooklyn, N. Y.

Business: Manufacture of bagging for baling cotton, and of cordage.

Original amount claimed: $521,191.58.

Final amount claimed: $1,448,734.54.

Amount finally allowed: $751,092.77.

Date of last determination: March 18, 1925.

Amortization deducted on property discarded or sold: $688,202.43.

Amortization deducted on reduced replacement costs: $62,890.34.

Amortization deducted on value in use: None.

Basis of last determination: Difference between depreciated cost and sale price or salvage value, also estimated residual value.

Amount based on solicitor's ruling and on sound engineering principles: $751,092.77.

Amount not based on solicitor's ruling: None.

Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: None.

NOTE.—The allowance is not questioned.

IRON AND STEEL

Name of taxpayer: American Rolling Mills Co., Middletown, Ohio.

Business: Flat metal sheets, steel castings, and corrugated metal sheets.

Original amount claimed: $201,751.13.

Final amount claimed: $2,597,982.94.

Amount finally allowed: $1,537,318.18.

Date of last determination: September 11, 1922.

Amortization deducted on property discarded or sold: $67,108.14.

Amortization deducted on reduced replacement cost: None.

Amortization deducted on value in use: $1,470,210.04.

Basis of last determination: Ratio of war-time capacity to estimated average postwar production. Ratio of occupants in main office building during war period to that during postwar period.

Amount based on solicitor's ruling and on sound engineering principles: $67,108.14.

Amount not based on solicitor's ruling: $1,470,210.04.

Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: None.

NOTE.—The following points are of interest in this case:

1. Taxpayer has two blast furnaces at Columbus, Ohio; sheet mills at Zanesville; open-hearth furnaces, blooming mill, bar mill, steel foundry, and sheet-products factory at Middletown, Ohio. The majority of the claim is based on value in use, only a small allowance being made on discarded facilities which is not questioned.

2. The original claim was only about 14 per cent of the amount finally allowed.

3. The principal allowances for value in use are computed on the basis of the ratio of postwar production for 1921 (actual), 1922 (6 months actual and 6 months estimated), and 1923 (all estimated) to war capacity. It is quite evident that a redetermination of the claim at or about March 3, 1924, would give a much higher value in use, if it did not entirely wipe out all amortization on this basis. The engineer even estimates less production in 1923 than he uses for 1922. The

condition of the steel industry in 1923 would certainly appear to make this extremely improbable.

4. The specific facilities have been listed to a considerable extent and the value in use applied to whole departments. While this report is better than some, a proper classification is not made. It can readily be seen, for instance, that a track for the open-hearth furnaces and the canopy over same may not have the same value in use as the furnaces, we will need a whole track and a whole canopy, not 69 per cent of the track and 69 per cent of the canopy.

5. This is one of the comparatively few cases in which account has been taken on certain items of the purchase of similar items in the postwar period and amortization disallowed on this ground. Although this engineer's report was made prior to the solicitor's ruling of August 19, 1923, it is in conformity therewith in this respect.

6. Proper account has not been taken of salvage value in determining value in use.

7. Proper investigation has not been made to determine whether facilities installed during the war were in the nature of replacement or additions.

8. The value-in-use percentage is applied to war cost less 1917 depreciation.

MUNITIONS

Name of taxpayer: American Shell Co., Paterson, N. J.
Business: Manufacture of shells for war use.
Original amount claimed: $1,202,267.67.
Final amount claimed: $864,721.77.
Amount finally allowed: $864,721.77.
Date of last determination: November 21, 1921.
Amortization deducted on property discarded or sold: $657,623.59.
Amortization deducted on reduced replacement costs: None.
Amortization deducted on value in use, $207,098.18.
Basis of last determination: Difference between cost and estimated postwar value.
Amount based on solicitor's ruling and on sound engineering principles: $657,623.59.
Amount not based on solicitor's ruling: None.
Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $207,098.18.

NOTE.—This case contains one unusual feature which will be briefly explained: The East Jersey Pipe Corporation (owned entirely by the Gillespie interests) built a shell plant for the manufacture of 3-inch shells for the English and Russian Governments. At the close of 1916 the contracts with the foreign governments were practically completed.

The original cost of this plant was	$820, 000
Depreciation written off on Dec. 31, 1916	569, 000
Residual value	251, 000

The American Shell Co. was incorporated on August 1, 1917 (all the stock in same being owned entirely by the same Gillespie interests). This corporation took over the munitions plant of the East Jersey Pipe Corporation, the value for the $251,000 plant shown above being now placed at $750,000. This plant, subject to additional capital expenditures during the war period, is the plant upon which amortization is computed. The plant manufactured 75-millimeter shells for the United States Government during the war.

It would appear that the $569,000 depreciation noted above was really amortization as provided for in the 1916 law on "munition manufacturer's tax."

Now, the bureau's engineer does not accept the cost of this plant to the American Shell Co. at either $251,000 (the depreciated value) or at $750,000 (the transfer value), but sets up a valuation of his own at date of transfer amounting to $562,969.89, and amortization is computed on this amount plus the cost of additional facilities.

The above raises the following questions: Did Audit tax the East Jersey Pipe Corporation on the profit arising from the sale to the American Shell Co.? If so, did they tax the difference between $251,000 and $750,000, or the difference between $251,000 and $562,969.89?

If the $569,000 taken as "depreciation" on an $820,000 plant in 1916 is really amortization is it possible to allow amortization again on this same plant in

1918, through writing up its value by a reorganization without real change of ownership?

The following points should also be noted in this case:

1. The facilities amortized in this case consisted of two large corrugated-iron buildings of substantial construction and shell-manufacturing machinery consisting of turret lathes, hydraulic lathes, milling and centering machines, special conveyors, etc. We are not questioning the amortization allowed in this case on sold or discarded facilities which constitute the larger part of the claim. We are questioning, however, the amortization allowed on buildings, piping, transmission lines, and a small amount of machinery retained in use. It appears that after the war this plant was converted into a factory for making small motors for washing machines. It is on the allowance made for the value in use of the items retained in use for this business that we raise objection.

2. The amount originally calimed is about 50 per cent greater than the amount finally allowed.

3. The basis of arriving at the percentage in use is as follows:

"Buildings and auxiliary building equipment: About 50 per cent amortization allowed on theory of floor space actually occupied in 1921 without allowance for expansion of business machinery. Based on the proposition of salvage value, because the value in use in 1921 is computed to be less than salvage value."

We do not agree with the value in use basis set forth. The amortization on buildings should not be based on floor space occupied but on the difference between the war cost of same and the postwar cost of a building suitable for the normal busines of taxpayer with suitable allowance for expansion.

We do not agree with the bureau's principle that a facility in use can be of as low a value as the salvage value of that facility.

Production for 1921, an abnormally poor year, is the only period considered.

4. The amortization is not allowed on specific facilities, but on large groups of facilities, contrary to the principles stated in solicitor's memorandum dated August 19, 1923.

5. No determination is made to see if the facilities purchased during the postwar period were similar to those installed during the war period on which a lowered value in use is claimed.

6. No consideration is given to the fact that salvage value should be taken into account in addition to the value in use.

7. No investigation is made to see if the war expenditures were in some cases in the nature of replacements, or in the nature of additions.

8. Value in use determined directly from war cost less 1917 depreciation.

SHIPBUILDING

Name of taxpayer: American Ship Building Co., Cleveland, Ohio.
Business: Shipbuilding.
Original amount claimed: $8,004,114.60.
Final amount claimed: $8,737,047.58.
Amount finally allowed: $3,567,509.60.
Date of last determination: January 18, 1923.
Amortization deducted on property discarded or sold: $2,659,339.92.
Amortization deducted on reduced replacement costs:
Amortization deducted on value in use: $908,169.68 (approximate).
Basis of last determination: Depreciated cost less residual values.
Amount based on solicitor's ruling and on sound engineering principles: $3,567,509.60.

NOTE.—The allowance in this case is not questioned, although the value in use of certain items is loosely determined.

Name: Ames Ship Building & Dry Dock Co., Seattle, Wash.
Business: Construction of steel ships.
Original amount claimed: $1,703,728.07.
Final amount claimed: $1,474,778.65.
Amount finally allowed: $1,018,642.72.
Date of last determination: August 17, 1920.
Amortization deducted on property discarded or sold: $1,018,642.72.
Basis of last determination: Estimated residual value or difference between what facilities cost and what it probably would bring when sold.
Amount based on solicitor's ruling and on sound engineering principles: $1,018,642.72.

NOTE.—The salvage value of this plant upon which amortization is based is not determined with any degree of accuracy. However, believing that the ultimate loss will equal or exceed that shown, we have not questioned this allowance.

MINING

Name: Anaconda Copper Mining Co., New York, N. Y.
Business: Copper, zinc, and ferromanganese.
Original amount claimed: $538,949.26.
Final amount claimed: $6,207, 932.31.
Amount finally allowed: $2,744,410.77.
Date of last determination: February 1, 1924.
Amortization deducted on property discarded or sold: None.
Amortization deducted on reduced replacement costs: None.
Amortization deducted on value in use: $2,744,410.77.
Basis of last determination: Average production method.
Amount based on solicitor's ruling and on sound engineering principles: None.
Amount not based on solicitor's ruling: $2,744,410.77.
Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: None.

The following points should be noted in connection with this case.

1. The nature of the facilities amortized consists of machinery and auxiliary equipment installed as additions or betterments to the taxpayer's regular equipment during the war period. This taxpayer is a very large copper producer whose combined plants furnish nearly one-tenth of the world's total annual copper output. Development costs are not included in the costs on which amortization is based. The following quotation on this point from the engineer's report should be noted:

"It has been held that costs covering work in connection with the development of a mine (shafts, drifts, crosscuts, etc.) is not in the nature of a facility. Such costs accordingly are not subject to amortization."

2. The original amount claimed was only about 20 per cent of the final allowance.

3. The basis of value in use is in general, the acceptance of the taxpayer's arbitrary per cent, because such percentages appear reasonable in view of the fact that the percentage of postwar average production for 1921, 1922, and 1923 to war capacity is lower than the per cent claimed by taxpayer. An examination of the production figures reveals the fact that after very low production in 1921 and subnormal production in 1922, the 1923 production came back to a figure very near to war production. In this connection note the following total production figures:

Annual production of copper in short tons by the Anaconda Co.

1913	130, 922	1919	64, 891
1914	103, 649	1920	69, 381
1915	117, 538	1921	16, 169
1916	153, 698	1922	70, 861
1917	119, 507	1923	121, 833
1918	136, 461		

If the monthly figures were used instead of total figures it would be found that in the last half of 1923, the production of copper was even closer to the rate attained during the war period. We believe there is no ultimate loss to this taxpayer as of March 3, 1924, on the basis of reduced value in use. Not one single item is shown in the engineer's report as having been discarded. If there are such items, the amortization granted on these would cover the real loss which should have been allowed the taxpayer.

4. The specific facilities have not been examined in order to determine the value in use of each, but the cost of whole mines or plants have been amortized on one average per cent.

For instance, a 50 per cent value in use is applied to war expenditures for the Butte mine properties, consisting of 26 mines operated from different shafts, although the mines are in a solid block of territory and more or less connected by cross cuts.

In order to give an idea of what kind of facilities have been grouped together before the value in use percentage is applied, we will also cite the case of the Anaconda smelter, which is one of the world's largest smelters. Here one value in use of 65 per cent has been applied to war expenditures on the following facilities grouped together in one lot:

Sulphuric acid plants.	Power plant facilities.
Zinc calcining plant.	Power substation.
Sampling mill.	Smelter power house.
Copper concentrators.	Machine shop.
Leeching plant.	Boiler shop.
Reverberatory plant.	Welding shop.
Coke pulverizers.	Paint shop.
Coke conveyors	Electric shop.
Copper casting plant.	Garage.
Weighing facilities.	General yard facilities.
Laboratory equipment.	Telephone facilities.
Fire protection plant.	Warehouse bin.
Quarry facilities.	Flue system stack foundry.
Brick plant.	Oil and waste saving plant.
Coal storage.	

It must be obvious that one value in use applied to the cost of the variety of items indicated by the above, can not be termed anything but a rough estimate and is certainly not exact enough for tax purposes. Special attention is called to amortization allowed on the item "fire protection," above. None of the plant facilities were discarded and it is obvious that if it is desired to protect the whole plant, no reduction on account of value in use of a fire protection system is justified. A fire protection system certainly does not function in relation to production, but must be sufficient to meet the emergency of fire.

This determination although made in February, 1924, does not conform to solicitor's ruling of August, 1923.

5. No investigation is noted in regard to the nature of postwar expenditures, which would prove, if made for facilities similar to those purchased during the war period, that taxpayer had full need of his war facilities. Such an investigation was necessary from the solicitor's ruling mentioned above.

6. No consideration has been given to the salvage value in reducing the actual loss from lowered value in use.

7. No investigation for the determination of the nature of the war expenditures, whether for replacements or for additions, was made.

8. Value-in-use percentages are applied to the war cost, less 1917 depreciation.

Note on specific facilities.—It appears that prior to the war this taxpayer had a stack 30 feet in diameter and 300 feet high which served the entire smelter operations at Anaconda. This was inadequate for war production, and moreover it was necessary to provide treatment for the gases escaping through the old stack and injuring the surrounding agricultural products. It is also to be noted that these gases contained considerable metal values which could be recovered by collection and treatment. A new stack and gas treating plant was therefore installed during the war period. The new stack was 585 feet high and 75 feet in diameter at the bottom and 60 feet in diameter at the top. The capacity of the stack is 3,000,000 cubic feet per minute. It appears the greatest postwar use has been 2,034,762 feet per minute. A value in use of 65 per cent is assigned to this item.

This might be a case where a lowered value in use would be permissible. However, if loss is claimed it should not be on the basis of a percentage of capacity but on the difference between the cost of the 3,000,000 cubic feet capacity stack and the 2,000,000 cubic feet capacity stack. The costs of these stacks obviously does not vary in direct proportion to their capacities.

SHIPPING

Name: Atlantic Coast Co., Boston, Mass.

Business: Transportation by water of goods aiding in prosecution of war.

Original amount claimed: $2,182,674.65.

Final amount claimed: $2,182,674.65.

Amount finally allowed: $1,136,330.80.

Date of last determination: July 17, 1923.

Amortization deducted on reduced replacement costs: $1,136,330.80.

Basis of last determination: Difference between war-time costs and the postwar tonnage value of vessels.

Amount based on solicitor's ruling and on sound engineering principles: $992,360.95.

Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $143,969.85.

NOTE.—Amortization is allowed above on 14 schooners. We are obliged to question the amortization on three of these schooners whose construction was started prior to April 6, 1917. The taxpayer was committed to the construction of these vessels prior to the war, and this is prima facie evidence that they were not acquired for war production or transportation.

Name: Atlantic & Pacific Steamship Co., New York, N. Y.
Business: Shipping.
Original amount claimed: $1,206,487.36.
Final amount claimed: $1,206,487.36.
Amount finally allowed: $1,029,223.36.
Date of last determination: July 26, 1924.
Amortization deducted on reduced replacement costs: $1,029,223.36.
Basis of last determination: Reduced replacement cost.
Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $1,029,223.36.

NOTE.—The above allowance is questioned in its entirety. The amortization is all allowed on a steel vessel, which was contracted for on February 17, 1917. It is our contention that as this was prior to the war, the vessel could not have been acquired for the purpose of prosecuting the war. Regardless of when payment for this ship was made, the taxpayer was committed to the purchase of same on February 17, 1917. Postwar replacement cost is fixed at $56 per deadweight ton.

OIL

Name: Atlantic Refining Co., Philadelphia, Pa.
Business: Operation of oil refineries, manufacture, and distribution of petroleum products.
Original amount allowed: $2,820,547.23.
Final amount claimed: $6,542,743.50.
Amount finally allowed: $3,165,001.67.
Date of last determination: February 2, 1924.
Amortization deducted on reduced replacement costs: $2,992,853.76.
Amortization deducted on value in use: $172,147.91.
Basis of last determination: Ratio of actual cost to postwar cost.
Amount based on solicitor's ruling and on sound engineering principles: $319,741.10.
Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $2,845,260.57.

The following general points should be noted in respect to this allowance:

(1) The facilities on which amortization is allowed may be classified as follows:

(a) Refining plant items.

(b) Distributing facilities.

(c) Tank steamers.

The greater portion of the allowance is based on the difference between war cost and postwar replacement value; this allowance will be discussed later and we will dispose of the value in use allowance first.

(2) The amount of amortization originally claimed is about 90 per cent of the amount finally allowed.

(3) The value in use is based on the ratio of the greatest number of man-hours worked during any month during 1921, 1922, and 1923 to the greatest number of man-hours worked in any month during the war period. This, then, is one of the few cases where it is recognized that the measure of usefulness in the postwar period is not the average productivity for 1921, 1922, and 1923, but the maximum or peak productivity during that period. Why this sound principle should be used in this case and discarded in the majority of cases is not evident. It shows the lack of any set of rules uniformly followed by this section. We are obliged to question allowances on reduced value in use mainly on account of the nature of the items. Note, for instance, the following items carried at a lowered value in use:

	Per cent in use
Lifting magnet for locomotive crane	65
Installation 15 by 24 feet office for boiler shop	65
Installation of motor drive for old stokers	92
Installation of fuel-oil system	92

It appears to us that a lifting magnet for a locomotive crane is clearly an accessory which is rarely used all the time, but pays for itself if used only occasionally in loading steel or iron. If such an item is used at all, we believe it to be of full value to taxpayer. We also doubt if an office only 15 by 24 feet, if needed at all, can be considered only 65 per cent of use to taxpayer. In the installation of a motor drive for old stokers it is obvious that an economy of operation is effected and that this is not a proposition of greater war capacity. The installation costs of fuel oil and piping system should not be based on a percentage, but on the difference in cost between a system which would be sufficient for taxpayer's postwar needs and the war cost of the system as installed.

(4) A part but not all of the specific facilities of taxpayer have been examined for the value in use determination.

(5) No investigation was made to see whether or not the taxpayer purchased in the postwar period facilities similar to those installed during the war period, as required by solicitor's memorandum of August, 1923.

(6) The salvage value of facilities has not been considered in arriving at the value in use.

(7) No consideration is given to the nature of war expenditures, whether for replacements or additions.

(8) The value in use percentage is applied to depreciated postwar replacement costs.

We desire in this case to discuss the allowance on account of lowered postwar replacement costs, as it brings out some new points in connection with this phase of amortization.

Under date of May 2, 1923, Engineers Woolson and Bellinger, of the bureau, reported that the taxpayer had set up his claim for amortization on lowered postwar replacement costs on the basis of the difference between an appraisal of December 31, 1921, and the war costs. This basis is denied and the amortization is figured on the standard method employed by the bureau as set forth in a Treasury decision. This computation of postwar replacement cost is made by determining the pre-war cost as of June 30, 1916, and applying thereto the standard published ratios to arrive at postwar replacement cost.

In a subsequent determination dated February 2, 1924, by Engineer Luce, this method is changed and amortization increased about $1,000,000 thereby. We question the special treatment accorded this one taxpayer in this determination. The special method employed in determining the postwar replacement cost is as follows: One particular construction job of the taxpayer is selected covering the installation of 16 new crude stills. The June 30, 1916, costs are determined for all the items in this contract. Then the Government ratios are applied to determine the postwar replacement cost. Now the result obtained by this means makes the replacement costs check within 2.2 per cent of the retrospective appraisal made as of December 31, 1921, and rejected by the first engineer examiner. In other words, a way has been found to practically check the retrospective appraisal by a method which contains the elements of the standard method, without giving the same result. Now, based on this one job, the replacement costs of the other war facilities are determined.

In regard to the amortization allowed on tank steamers the following matter is presented:

Name of vessel	Dead-weight tonnage	Date		Contract price
		Contract awarded	Contract finished	
J. E. O'Neil	10,155	Apr. 11, 1916	Jan. 10, 1918	$1,350,000
H. L. Pratt	10,122	do	Mar. 1, 1918	1,350,000
W. M. Irish	10,115	Oct. 27, 1916	May 2, 1918	1,500,000
W. M. Burton	10,115	do	June 25, 1918	1,500,000
Total				5,700,000

Name of vessel	Net cost of changes and extras	Total cost deliveries to A. R. Co.	Expenditures prior to Apr. 6, 1917	Expenditures subsequent to Apr. 6, 1917
J. E. O'Neil	$104,721.76	$1,454,721.76	$135,281.82	$1,319,439.94
H. L. Pratt	232,029.73	1,582,029.73	135,281.82	1,446,747.91
W. M. Irish	292,587.94	1,792,587.94	150,000.00	1,642,587.94
W. M. Burton	326,043.44	1,826,043.44	150,000.00	1,676,043.44
Total	955,382.87	6,655,382.87	570,563.64	6,084,819.23

Amortization on the above four steel tank steamships has been allowed in the amount of $2,365,958.32. We believe this whole allowance to be illegal.

All of these tankers were contracted for well before our entry into the war and the taxpayer was committed to their construction. The bureau admitted that commitments made in 1918, but not paid for, as in the Berwind-White case, could be amortized. Here we have commitments prior to the war amortized; this is absolutely inconsistent. Note the following statement of Mr. Tandrow, appraisal engineer of the bureau, in the Berwind-White case, as shown on page 840 of the hearings:

"Mr. TANDROW. Well, just consider this, that prior to April 6, 1917, the United States had not entered the war. That is absolute evidence that any commitments prior to April 6, 1917, were not for the prosecution of the war against the German Government, in so far as we are concerned. Therefore, you should not include commitments."

We agree with Mr. Tandrow that the statute required facilities on which amortization could be allowed to be acquired for the purpose of prosecuting the war, and that it is prima facie evidence that if a vessel was contracted for prior to the war period, it can not be held to have been acquired for this purpose. It is possible that the changes and extras, if made for war purposes and contracted for after April 6, 1917, might be amortizable. But in this case these expenditures were only $955,382.87, and the amortization thereon would nor exceed $300,000 instead of the $2,000,000 allowed.

There is one more point to note in this allowance. Amortization is granted on oil and gasoline distributing stations located throughout Pennsylvania as follows:

Avella, Pa.
Sagamore, Pa.
Henrys Mills, Pa.
Newtown, Pa.
Shinglehouse, Pa.
Royersford, Pa.
Marion, Pa.
Walgrove, Pa.
Grand Valley, Pa.

Amortization allowed amounts to $107,944.08. We fail to see how these distributing stations were installed for the purpose of contributing to the prosecution of the war. We quote from the first engineer's report:

"It is noted during the inspection of the various distributing stations that the service ordinarily rendered in the serving of public motor vehicles with gasoline was an ordinary activity of the distributing stations."

Distribution of gasoline to pleasure automobiles did not help the war; on the other hand, it hindered it. Much pressure was exerted during the war period, in fact, to discourage use of automobiles for pleasure. We do not believe it was the intent of Congress to grant amortization on such facilities.

IRON AND STEEL

Name: Atlas Crucible Steel Co., Dunkirk, N. Y.
Business: Manufacture of specialized tool steel.
Original amount claimed: $251,803.20.
Final amount claimed: $778,440.74.
Amount finally allowed: $710,793.23.
Date of last determination: April 25, 1922.
Amortization deducted on property discarded or sold: $119,634.84.
Amortization deducted on value in use: $591,158.39.
Basis of last determination: Ratio of war-time capacity to estimated post-war production.
Amount based on solicitor's ruling and on sound engineering principles: $119,634.84.
Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $591,158.39.

NOTE.—The following points should be noted in connection with this allowance:

(1) The nature of the facilities amortized in this case consist of those necessary in manufacturing specialized tool steel, such as buildings, open-hearth furnace, melting equipment, hammer-shop equipment, electric power installations, etc. We are not questioning the amortization allowed on facilities abandoned or sold as shown in the engineer's report.

(2) The original claim amounted to only about 36 per cent of the amount finally allowed.

(3) The value in use percentage is, in general, determined by the ratio of average production for the years 1919, 1920, and 1921 to war capacity. The date of the engineer's report is April, 1922. We have no way of finding out the production of this company in 1922 and 1923, but use of the years 1919 and 1920 does conflict with the later policy of the bureau to discard these years as being nonrepresentative of the postwar period.

(4) Each specific facility of taxpayer has not been examined, but the facilities have been examined in well-classified groups.

(5) No determination of the nature of postwar expenditures has been made, although the amounts have been given. The total plant expenditures for each year from 1912 to 1921, inclusive, follows:

	Plant investment for year		Plant investment for year
1912	$62, 086. 15	1917	$356, 762. 99
1913	55, 717. 74	1918	611, 463. 20
1914	10, 673. 56	1919	481, 570. 87
1915	12, 043. 08	1920	848, 921. 76
1916	145, 948. 32	1921	1, 113, 069. 55

The end of the amortization period for this taxpayer is April 1, 1919.

From the above figures, it can be seen that it was of supreme importance to examine the postwar expenditures to see if they were for items similar to those installed during the war, thus furnishing prima facie evidence that the war facilities were needed. This has not been done, and we are obliged to question the value in use allowances. It will be noted that the postwar expenditures of 1920 and 1921 were double those of the war years 1917 and 1918.

The examining engineer states as follows:

"After the end of the war period every effort was made to utilize the excess capacity by turning attention to the manufacture and development of steel alloy for which it was thought a postwar demand might exist.

"The futility of this effort can best be seen in the fact that in 1921, with the sales totaling $1,130,000, the company suffered a net operating loss of $72,500, as the terrific burden of overhead charges on account of enlarged plant was too great to overcome. The schedule of additions to plant equipment shows a further expenditure of over $2,000,000 in 1920 and 1921. This move was a most important one and is largely responsible for the present condition of the company."

We realize that this company made a mistake in their postwar policy, and we sympathize with them, but we can not see how, as a matter of principle, the policy of the taxpayer in the postwar period, which put the company in bad financial condition, can be blamed on the war, when the war had nothing to do with it.

The fact that the taxpayer made large postwar expenditures of a similar nature to those made during the war is prima facie evidence that the taxpayer suffered no loss due to the war. His loss was due to excessive postwar expansion, and his only relief is under loss of useful value deductions.

(6) No weight has been given to the salvage value of items in determining their value in use.

(7) No investigation was made to determine whether war expenditures were in the nature of replacements or of additions.

(8) The value in use percentage has been applied to war cost less 1917 depreciation.

MUNITIONS

Name of taxpayer: Atlas Powder Co., Wilmington, Del.; Richards & Co. (subsidiary), Stamford, Conn.

Business: Manufacture of high explosives.

Original amount claimed: $1,748,080.30.

Final amount claimed: $1,954,275.45.

Amount finally allowed: $1,882,054.67.

Date of last determination: January 30, 1922.

Amortization deducted on property discarded or sold: $1,022,138.07.

Amortization deducted on value in use: $859,916.60.

Basis of last determination: Estimated residual values; ratios of war-time capacity to postwar production.

Amount based on solicitor's ruling and on sound engineering principles: $1,022,138.07.

Amount not based on solicitor's ruling, $859,916.60.

NOTE.—The following points should be noted in this case:

(1) The business of the taxpayer during the pre-war and postwar period was the manufacture of high explosives for commercial purposes. From 1915 to 1917 the taxpayer manufactured large quantities of high explosives for the British, French, and Russian Governments. Upon the entry of the United States into the war, nearly the entire output of the taxpayer was furnished to our Government. Considerable plant expenditures were made and a new plant constructed at Forcite, N. J. This latter plant was practically discarded subsequent to the war and nearly all the amortization based thereon is computed from the discarded value. We do not therefore question this allowance. A considerable portion of the war expenditures at the pre-war plants of the taxpayer can be used in the taxpayer's regular business, and it is these allowances that are questioned.

(2) The original amount claimed by the taxpayer was slightly less than the amount finally allowed.

(3) While the basis of value in use of facilities is evidently based on the ratio of postwar production to war capacity, inasmuch as production figures are not given in the engineer's report, it is difficult to form an opinion on the propriety of the percentages used. The report being dated as of January, 1922, it is evident that the value in use can not very well show the ultimate loss to the taxpayer as of March 3, 1924. If any allowance was made for 1922 and 1923 production, it must have been estimated. In a few cases value in use has evidently been arrived at by direct guess instead of by the production method.

(4) The specific facilities have not been examined in detail, but the value in use percentage applied to whole departments.

(5) No investigation has been made as to the extent or nature of postwar expenditures.

(6) No consideration is given to the effect of salvage value on the value in use.

(7) No determination was made to ascertain whether the facilities installed during the war period were in the nature of replacements or of additions.

(8) The value in use per cent was applied to war cost less 1917 depreciation.

MACHINERY MANUFACTURING

Name: Babcock & Wilcox, New York, N. Y.

Business: Manufacture of boilers, tubes, and breechings, stokers, etc.

Original amount claimed: $4,274,215.89.

Final amount claimed: $4,274,215.89.

Amount finally allowed: $2,145,625.28.

Date of last determination: January 9, 1925.

Amortization deducted on property discarded or sold: $96,553.14.

Amortization deducted on value in use: $2,049,072.14.

Basis of last determination: Ratio of average monthly production from January 1, 1917, to December 31, 1918, to average monthly postwar production from January 1, 1919, to December 31, 1921; also salvage value.

Amount based on solicitor's ruling and on sound engineering principles: $96,553.14.

Amount not based on solicitor's ruling: $2,049,072.14.

The following points should be noted in connection with the above allowance:

(1) This taxpayer operates three plants, as follows:

(a) Bayonne plant, consisting of facilities necessary in the manufacture of Babcock & Wilcox stationary and marine boilers, superheaters, stokers, oil burners, etc.

(b) Barberton plant, consisting of facilities necessary in the manufacture of Stirling boilers, fittings, etc.

(c) Beaver Falls plant, consisting of facilities necessary in the manufacture of seamless tubing for marine and stationary boilers.

Taxpayer furnished a large amount of machinery to Government departments during the war. Amortization on discarded facilities is not questioned.

(2) The original amount claimed was about 100 per cent greater than the amount finally allowed.

(3) The value in use percentage is taken as the ratio of the average monthly war production from January 1, 1917, to December 31, 1918, to the average monthly postwar production from January 1, 1919, to December 31, 1921. The first report was made in this case in 1922, but the final revised allowance was not made until January 9, 1925. In spite of this fact, no production figures are given for the postwar years 1922 and 1923, which are the years almost always used in

other cases. We see, therefore, again a lack of uniformity in the determination of amortization. Almost all cases of amortization are based on 1921, 1922, and 1923 production. Here the years 1919, 1920, and 1921 are used, although the final report was not issued until January, 1925, and therefore such figures could have been obtained. Sufficient is said in the engineer's report to show that the year 1923 was much better than the two former years. For example, in a report dated January 28, 1923, the following statement is made:

"It was found that even though mill No. 1 were working night and day, it would not be able to produce the company's estimated requirements of tubes and it would be necessary for the company to put in an extra mill at this time to take care of its requirements or purchase same in open market.

"It was stated that if a mill was installed it would have about the same capacity as mill No. 2.

"After much discussion, the taxpayer's representative tentatively accepted 30 per cent as a fair deduction for amortization.

"Taking into consideration the probable lowered replacement cost and the fact that the mill has not operated over 70 per cent of the time during postwar years, it is deemed that 30 per cent is a reasonable deduction for amortization for all facilities which have not been permanently discarded, and it is recommended that same be allowed."

From the above it can be seen the amortization is granted on property which was not sufficient to meet the taxpayer's needs in 1923, even if working night and day.

For the reasons shown above, which are typical to a great extent, we are obliged to question the value in use allowances in this case.

(4) Some of the facilities have been specifically examined and a salvage value placed thereon. In the majority of cases the items have been grouped and the value in use determined by the application of one percentage found from the production of the entire plant.

(5) No investigation is made to determine the nature of postwar expenditures, in order to see if they were of the same nature as war expenditures, and thus prove taxpayer's full need for the war equipment.

(6) Proper allowance has not been made for salvage value in determining value in use.

(7) No investigation has been made to determine whether war expenditures were for replacements or additions.

(8) Value in use percentage is applied to war cost less 1917 depreciation.

We also wish to present the following facts:

This is the only case we have found to date where the taxpayer notified the unit that he put back into use discarded facilities.

This is also the only case we have found to date where the taxpayer notified the unit of contractual amortization received after the allowance for amortization for tax purposes had been made.

Name: Baldwin Locomotive Works, Philadelphia, Pa.
Business: Manufacture of steam and electric engines.
Original amount claimed: None stated in engineer's report.
Final amount claimed: $4,070,630.53.
Amount finally allowed: $2,990,806.64.
Date of last determination: June 15, 1921.
Amortization deducted on value in use: $2,990,806.64.
Basis of last determination: Comparison of estimated use of different plant units during war time to that during postwar period.
Amount not based on solicitor's ruling: $2,990,806.64.

NOTE.—The following points should be noted in connection with this allowance:

(1) Taxpayer's business is the manufacturing of steam locomotives. The entire allowance is based on the value in use of facilities purchased during the war period for plant expansion.

(2) The amount of the original claim is not stated.

(3) The value in use percentage is the estimate of the bureau's engineer, as modifying somewhat the ratios determined by the taxpayer on a production basis. The value in use percentages are as follows: 44.4 per cent, 66.7 per cent, 60 per cent, and 80 per cent. These four percentages are applied to the war expenditures throughout this enormous plant.

(4) The specific facilities of the taxpayer have not been examined. This is not in accordance with solicitor's ruling of August, 1923, and the entire allowance must be questioned.

(5) No investigation is made as to the nature of postwar expenditures.

(6) Proper allowance has not been made for salvage value in determining value in use.

(7) No investigation is made to determine whether war expenditures were for replacements or for additions.

(8) The value in use percentage is applied to war cost less 1917 depreciation.

SHIPBUILDING

Name: Baltimore Dry Dock & Shipbuilding Co., Baltimore, Md.
Business: Shipbuilding.
Original amount claimed: None stated.
Final amount claimed: $3,812,306.36.
Amount finally allowed: $3,384,965.86.
Date of last determination: June 16, 1921.
Amortization deducted on property discarded or sold: $3,384,065.86.

Basis of last determination: Difference between depreciated cost and salvage value; also difference between actual cost and estimated value of portion of plant closed down but neither scrapped nor sold.

Amount based on solicitor's ruling and on sound engineering principles: $3,384,965. 86.

NOTE.—This allowance is not questioned, although no check has been made by the bureau to see whether or not taxpayer had in use as of March 3, 1924, any of the items he claimed he was going to discard at the time of the engineer's report.

MACHINERY MANUFACTURING

Name: Bartlett Hayward Co., Baltimore, Md.
Business: Founders, machinists, and manufacturers o' shells, etc.
Original amount claimed: $1,508, 819.03.
Final amount claimed: $1,459,368.34.
Amount finally allowed: $1,442,056.43.
Date of last determination: April 7, 1922.
Amortization deducted on property discarded or sold: $697,515.27.
Amortization deducted on value in use: $744,541.16.

Basis of last determination: Difference between depreciated cost and sales price. Ratio of the "capacity of facilities retained in use to the 1921 production and what it is reasonable to expect will be produced in 1922."

Amount based on solicitor's ruling and on sound engineering principles: $697, 515.27.

Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $744,541.16.

The following points should be noted in connection with this case:

(1) "The business of this taxpayer prior to June, 1917, was that of founders, machinists, and engineers, specializing in the production of gas plants, stoves, furnaces, elevators, sugar and oil machinery, etc. During 1917, 1918, and 1919 facilities were acquired for producing shells for the United States Government." A considerable proportion of the amortization allowance is on facilities discarded or sold; this portion of the allowance is not questioned.

(2) The original claim for amortization was about 5 per cent greater than the final allowance.

(3) The value in use percentage is taken as the ration between 1921 production averaged with what can reasonably be expected for 1922 production, to the war capacity. We are obliged to question the allowance made on the above basis, as business conditions were abnormally bad in 1921, which fact would materially increase the amortization allowed.

(4) The specific facilities of the taxpayer appear to have been examined.

(5) Considerable postwar expansion was admitted in this engineer's report. No investigation was made as to the nature of facilities purchased in the postwar period. In accordance with solicitor's memorandum of August, 1923, if the postwar facilities were of a like or similar nature to those purchased during the war period, amortization would not be allowable on such war purchases.

(6) Proper account is not taken of the salvage value of items retained in use.

(7) No investigation is made to determine whether war expenditures were for replacements or for additions.

(8) The value in use percentage is applied to war cost less 1917 depreciation.

MISCELLANEOUS

Name: Bauer & Black, Chicago, Ill.
Business: Manufacture of surgical dressings and allied products.
Original amount claimed: $176,822.57.
Final amount claimed: $537,726.07.
Amount finally allowed: $537,726.07.
Date of last determination: April 14, 1921.
Amortization deducted on property discarded or sold: $372,331.73.
Amortization deducted on value in use: $165,394.34.
Basis of last determination: Occupancy of building.
Amount based on solicitor's ruling and on sound engineering principles: $122,869.47.
Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $414,856.60.

The following points should be noted in connection with this allowance:

(1) The business of the taxpayer is the manufacture of surgical dressings and allied products. The principle allowance is on buildings. We do not question the allowance on buildings or machinery actually discarded, with the exception of contractual amortization not deducted which we will explain later.

(2) The original claim for amortization was only about 35 per cent of the final allowance.

(3) The value in use percentage (about 50 per cent) has been assigned as per the following statement in the engineer's report:

"Building No. 10 is a 7-story and basement building of reinforced concrete adjoining the old plant of the taxpayer. It was erected in the period August to December, 1918, and cost $325,394.34. Amortization of about 50 per cent, or $165,394.34, is claimed. A little more than half of this building is now occupied, but there is in the taxpayer's original buildings enough vacant space to contain practically all of the activities carried on in the new building. The taxpayer could therefore dispense with the new building entirely and have ample room for all departments. The number of employees is now smaller than before the war and will probably not increase appreciably for a long time. It is therefore evident that the value in use of the new building No. 10 is at present practically nil. However, in anticipation of a gradual growth, and the possibility of developing a new product or two that would use up some of the space, the taxpayer assigned a value in use of about 50 per cent, or $160,000. As this is based on possibilities that are entirely problematical, it is considered quite reasonable, and amortization as claimed is therefore recommended.

We radically disagree with the principles stated in the above paragraph. If the taxpayer discarded his old pre-war buildings, the law gives him full right to charge off loss of useful value on them. They had nothing to do with amortization on the new building. As a matter of fact the new building was over 50 per cent occupied in 1921 and it is admitted that an allowance should be made in "anticipation of a gradual growth." Certainly a value in use of at least 70 per cent should have been given to this building instead of the 49 per cent actually allowed.

(4) The specific facilities of taxpayer have been examined.

(5) No mention is made of postwar expenditures by taxpayer.

(6) Salvage value of building has not been considered as affecting value in use.

(7) It is not shown whether buildings erected were in the nature of replacements or additions.

(8) Value in use percentage has been applied to war cost.

There is a special feature to this allowance which will now be discussed. In the cases presented in the hearings where amortization, called "contractual amortization," was allowed taxpayer from a contracting department of the Government in payment of costs of war facilities, the following rule was laid down as being the practice of the bureau:

Where contractual amortization is received by the taxpayer, the costs subject to amortization for tax purposes shall be reduced by the amount of such amortization and the allowance for tax purposes figured on the remaining costs, which are really the only costs borne by the taxpayer. Amounts received as contractual amortization will be excluded from income in whatever year received and no tax paid thereon.

In this case the taxpayer followed the general rule laid down above and was required by the engineer's report to add on amortization and do everything just contrary to the rule above. Note the following quotation from the engineer's report:

"Schedule A-19 submitted with the income-tax return called for amortization in the sum of $176,822.57 on property costing $762,931.77. Through a misunderstanding of the relation, or rather lack of relation, between War Department amortization and income-tax amortization, claim was not included for amortization in the sum of $360,903.50, which had been written off on the taxpayer's books as such on the basis of War Department allowances. In other words, the sums allowed by the War Department should be returned as income, and the income tax amortization claim should be made greater than the sum of $360,903.50, giving a total claim of $537,726.07. The claim was revised by the taxpayer accordingly after the proper method of building up the claim had been made clear."

The above quotation speaks for itself. If the taxpayer made a big profit in 1918 and a relatively smaller profit when he received the contractual amortization, he has benefited largely in lowered tax. We have not the tax figures to determine what is actually the case.

SCIENTIFIC INSTRUMENT AND OPTICAL GLASS INDUSTRY

Name: Bausch & Lomb, Optical Co., Rochester, N. Y.

Business: Manufacture of optical and scientific instruments and optical glasses.

Original amount claimed: $2,493,094.31.

Final amount claimed: $2,682,539.41.

Final amount allowed: $2,377,789.21.

Date of last determination: February 20, 1922.

Amortization deducted on property discarded or sold: $1,092,588.46.

Amortization deducted on value in use: $1,285,200.75.

Basis of last determination: Discarded values and occupancy of buildings.

Amount based on solicitor's ruling and on sound engineering principles: $1,423,789.08.

Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $954,000.13.

The following points should be noted in connection with this allowance:

(1) The regular business of this taxpayer is the manufacture of optical and scientific instruments and optical glass. During the war the taxpayer manufactured range finders, gun sights, periscopes, field glasses, telescopes, etc. Allowances made for discarded facilities are not questioned. There is no doubt that the taxpayer has excess floor space in his buildings, however,, on the buildings partially in use sufficient allowance is not made for future expansion and a portion of the allowance thereon is questioned. We also question certain allowances on fire apparatus and furniture retained in use and on hand.

(2) The original claim was about 5 per cent greater than the amount finally allowed.

(3) The value in use percentage is obtained from the ratio of the space occupied in buildings to the space available. Sufficient allowance is not made for future needs and a reasonable margin of safety.

(4) The specific facilities are not examined but one value in use is applied to grouped facilities.

(5) No investigation is made of the nature of postwar expenditures.

(6) Proper account is not taken of salvage value in determining value in use.

(7) No investigation is made to determine whether the war expenditures were in the nature of replacements or additions.

(8) Value in use percentage is applied to war cost less 1917 depreciation.

(9) Land is amortized to the extent of $62,947.04.

Two items are to be specially noted for the sake of principle rather than magnitude:

(a) Amortization is allowed to the amount of $32,867.29 on fire protection equipment on the basis that it is only the same percentage in use that the building is occupied. We believe this theory erroneous. It appears common sense that though we only occupy 50 per cent of the space in our building, it must be fully protected from fire, in all places, occupied or not, in order to protect the part that is occupied. We believe fire apparatus must be considered as discarded or in full use.

(b) Amortization of $2,303.50 is allowed on office fixtures, desks, chairs, tables, cabinets and typewriters. It is stated in the engineer's report, that "none of these facilities have been sold nor is it the intention of the company to dispose of any." A 50 per cent in use value is assigned on the basis that they are at least in use to that extent.

We wish to use this item for illustration:

Suppose there are four typewriters on this list that cost only $100 each in 1918. Then:

Total cost	$400
Value in use 50 per cent	200
Amortization allowed	200

Now if these four typewriters are in use 50 per cent of the time, two typewriters ought to supply the needs of the company and two could be sold. In this case the computation would be:

Cost of 2 typewriters	$200
Sale price, at $30 each	60
Total amortization allowed	140

The preceding shows clearly that the salvage value not being considered in the first example gives excessive amortization.

If the first computation had been made correctly, it would have been figured as follows, and would have checked the first computation.

Total cost 4 typewriters	$400
Salvage value, at $30 each	120
Excess of cost over salvage value	280
Value in use equals 50 per cent	140
Total amortization	140

The error shown in the first computation is typical throughout the cases examined. As shown above, this error can be mathematically proven.

We also wish to state that there appears to be a serous error in computing the amortization in this case. The engineer states in regard to building No. 14, as follows:

"A use value of 50 per cent of cost, which represents the actual use value at the present time is allowed."

The engineer then proceeds to compute the use value at only 40 per cent in his computations. This makes an allowance of $75,079.83 too great in favor of the taxpayer.

IRON AND STEEL

Name: Bethlehem Steel Co., Bethlehem, Pa.
Business: Steel and steel products, also munitions.
Original amount claimed: None stated.
Final amount claimed: $48,008,536.73.
Amount finally allowed: $22,103,942.43.
Date of last determination: April 25, 1923.
Amortization deducted on property discarded or sold: $9,822,588.58
Amortization deducted on reduced replacement costs: $10,045,243.99.
Amortization deducted on value in use: $2,236,109.86.

Basis of last determination: Difference between depreciated cost and sales price and estimated salvage value, application of special ratios on replacement costs and ratio of war-time capacity to average postwar production.

Amount based on soliciter's ruling and on sound engineering principles: $14,845,210.57.

Amount not based on sound engineering principles and not specifically condemend by solicitor's ruling: $7,258,731.86.

The following points should be noted in connection with this claim:

(1) The main business of the taxpayer is iron and steel, but he is also engaged in a wide variety of related industries, among which might be mentioned steel shipbuilding and munitions. To get any idea of this claim it will be necessary to list the various plants and the amortization allowed to each, as follows:

Bethlehem Steel Corporation (parent)

Name of company and plant	Amortization allowed on lowered replacement cost	Amortization allowed on property discarded or sold	Amortization allowed on value in use
Bethlehem Steel Co.:			
Bethlehem plant	$1,770,990.84	$8,248,233.82	$881,651.72
Redington proving grounds	364.68	3,904.98	
Redington fuse plant	511.20	35,046.57	
New Castle plant		131,650.67	
Steelton plant	563,679.08	13,770.31	10,468.33
Lebanon plant	89,431.34		
Maryland plant	6,552,593.87		
Bethlehem-Chile Iron Mining Co.	293,682.51		
Juragua Iron Co.	2,373.54		
Spanish-American Iron Co.	241,808.93		
Bethlehem Mines Corporation:			
Bethlehem quarry	141,472.57		
McAfee quarry	133,519.75		
Steelton quarry	3,024.31		
Hanover quarry	12,058.17		
Penn-Mary Coal Co.	28,637.98		
General plant			125,204.10
Bethlehem Ship Corporation:			
Fore River plant		64,561.37	553,346.55
Moore plant	16,921.12	165,190.93	22,525.38
Harlan plant	7,789.83	32,487.60	
Sparrows Point plant	54,211.97		
Watson Hill Development Co.		245,624.87	
Bethlehem Steel Corporation:			
Philadelphia, Bethlehem & New England R. R.	38,605.48		
Patapsco & Back River R. R. Co.	60,234.34		
Steelton & Highspire R. R. Co.	8,754.04		
Union Iron Works	15,578.44	882,111.46	642,913.72
Union Iron Works Dry Dock			
Total	10,045,243.99	9,822,588.58	2,236,109.86

Grand total, $22,103,942.43.

The greater portion of the allowance to this taxpayer has been based on discarded value or lowered postwar replacement costs. Considerable amortization has been allowed on lowered value in use, and this is treated of in the remaining eight points.

(2) The original claim of the taxpayer is not stated.

(3) The value in use percentage is based on different considerations in the different groups on which lowered value in use has been applied. In general, however, it is represented by the ratio between postwar production and war capacity.

(4) The amortization has been determined on groups of items instead of on each specific facility.

(5) No investigation has been made as to the nature of postwar expenditures.

(6) Proper allowance has not been made for the salvage value of items retained in use.

(7) No investigation has been made to determine whether the war expenditures were for replacements or for additions.

(8) The value in use percentage has been applied to depreciated postwar replacement cost.

(9) Amortization has been allowed to the Watson Hill Development Co., a subsidiary of the corporation, on the housing project. The amount of the allowance to the company is $245,624.87. This is directly contrary to the ruling of the solicitor published October 26, 1925.

The Bethlehem Steel Corporation was allowed amortization on three subsidiaries, as follows:

Philadelphia, Bethlehem & New England R. R. Co.	$38,605.48
Patapsco & Back River R. R. Co.	60,234.34
Steelton & Highspire R. R. Co.	8,754.04
Total	107,593.86

We do not believe that the taxpayer will suffer any ultimate loss on facilities retained in use. There are a few general matters which should be noted in connection with this allowance in addition to the points set out above, covering only the facilities retained in use.

The Bethlehem Steel Corporation was allowed a normal rate of depreciation of 6⅔ per cent, and for the war years it was allowed extraordinary depreciation, 50 per cent greater than this figure. The total allowance for depreciation then to the Bethlehem Steel Corporation was 10 per cent annually for the war years. This is just about double the rate allowed the United States Steel Corporation for the same years. We can see no reason for such inconsistent allowances to taxpayers whose business is so similar as in this case. This excessive depreciation allowed during the war period is on those very facilities which are amortized as well as the pre-war facilities of the taxpayer. The importance of these depreciation percentages may be realized when it is remembered that the annual depreciation deduction of the United States Steel Corporation, even on a 5 per cent basis, amounts to $40,000,000 or $50,000,000 per annum.

The same inconsistency which exists in depreciation allowances between the Bethlehem Steel Corporation and the United States Steel Corporation exists in the case of the lowered postwar replacement cost computed by the bureau. Postwar replacement cost allowed the Bethlehem Steel Corporation was 40 to 50 per cent greater than the figure for the United States Steel Corporation, and this results in a correspondingly greater amount allowed for amortization to the Bethlehem Steel Corporation. We have been obliged to question, therefore, a considerable portion of the allowance made to the Bethlehem Steel Corporation on the basis of lowered postwar replacement cost.

There is one more point which stands out prominently when the whole matter of the amortization allowed to the Bethlehem Steel Corporation is considered. The Bethlehem Steel Corporation, in the postwar period, purchased the steel business of the Lackawanna Steel Co., and the Midvale Steel Co. A good price was paid for both of these large properties. We consider this prima facie evidence that the Bethlehem Steel Corporation did not have excessive facilities, for if it had, it would not have purchased in the postwar period, these other plants.

As proving that the war investments of the Bethlehem Steel Corporation constituted no ultimate loss to this corporation, the following statement of Mr. Charles M. Schwab as contained in the Washington Post of October 2, 1925, should be noted:

"Bethlehem's marvelous plant for producing munitions has been turned 99 per cent to production of implements of peace, and all of Bethlehem's investment in new properties and new advancement is in full confidence that the years to come will be years of peace."

MACHINERY MANUFACTURES

Name: E. W. Bliss Co., Brooklyn, N. Y.

Business: Manufacture of automatic machinery, also torpedoes for United States Government.

Original amount claimed: $1,731,746.97.

Final amount claimed: $1,730,746.97.

Amount finally allowed: $1,243,571.09.

Date of last determination: May 26, 1922.

Amortization deducted on property discarded or sold: $96,930.69.

Amortization deducted on value in use: $1,146,640.40.

Basis of last determination: Estimated use value to taxpayer in going postwar business.

Amount based on solicitor's ruling and on sound engineering principles: $336,132.34.

Amount not based on solicitor's ruling: $558,149.88.

Amount not based on sound engineering principles and not specifically condemned by solocitor's ruling: $349,288.87.

The following points should be noted in connection with this allowance:

(1) The taxpayer's regular business is the manufacture of automatic machinery. During the war period its principal product was torpedoes for the United States Government.

(2) The original claim was about 40 per cent in excess of the amount finally allowed.

(3) The value in use percentage is the direct estimate of the engineer as to the percentage of use in the taxpayer's going business. Proper account is not taken of future expansion in the business, and part of the allowance on buildings is therefore questioned.

(4) The specific facilities of taxpayer other than buildings and piers have not been examined. One value in use is applied to machinery items as a whole

These items cost in excess of $880,000. This method is not in conformity with solicitor's ruling of August, 1923, and the allowance is therefore questioned.

(5) The nature of postwar expenditures is not determined.

(6) Proper account is not taken of salvage value in determining value in use.

(7) No investigation is made as to whether war expenditures were in the nature of replacements or additions.

(8) Value in use percentage is applied to war cost less 1917 depreciation.

Name: J. G. Brill Co., Philadelphia, Pa.

Business: Manufacture of electric railway cars and trucks, motor cylinders, searchlights, and other necessities.

Original amount claimed: Not stated.

Final amount claimed: $900,788.54.

Amount finally allowed: $603,182.63.

Date of last determination: May 26, 1921.

Amortization deducted on property discarded or sold: $132,631.75.

Amortization deducted on value in use: $470,550.88.

Basis of last determination: Difference between depreciated cost and sales price or scrap value, estimated use value to taxpayer in normal postwar business.

Amount based on solicitor's ruling and on sound engineering principles: $132,631.75.

Amount not based on solicitor's ruling: $470,550.88.

The following points should be noted in connection with this allowance:

(1) The regular business of this taxpayer is the manufacture of electric railroad cars and trucks. During the war period the taxpayer manufactured motor cylinders, searchlights, and other war necessities. A small portion of the facilities acquired for the war work were discarded, and the allowance for amortization made thereon is not questioned. The greater portion of the facilities were however, adapted for use in the taxpayer's business, and we believe the ultimate loss on such facilities will be practically nil.

(2) The original amount claimed for amortization by this taxpayer is not available.

(3) The value-in-use percentage is obtained by direct estimate of useful value of taxpayer's normal postwar business.

(4) The specific facilities amortized have been listed, but the value in use has been applied to very large groups of facilities as a whole. This is not in accordance with the solicitor's ruling of August, 1923.

(5) No investigation has been made as to the nature of postwar expenditures.

(6) Proper account is not taken of salvage value in determining value in use.

(7) No investigation is made to determine whether the war expenditures were in the nature of replacements or additions.

(8) Value-in-use percentage has been applied to the war costs less 1917 depreciation.

IRON AND STEEL

Name: Brier Hill Steel Co., Youngstown, Ohio.

Business: None stated in engineer's report.

Original amount claimed: $3,498,676.88.

Final amount claimed: $9,293,733.28.

Amount finally allowed: $6,217,973.95.

Date of last determination: February 15, 1923.

Amortization deducted on property discarded or sold: $6,217,973.95.

Basis of last determination: Sale of total assets.

Amount based on solicitor's ruling and on sound engineering principles: $6,217,973.95.

NOTE.—The above allowance is not questioned on account of the lack of information. The market value of $76 per share of stock issued in payment of property is not properly substantiated.

Five per cent depreciation is taken for all years as the proper rate for the steel business

MACHINE TOOLS

Name: Brown & Sharpe Manufacturing Co., Providence, R. I.

Business: Manufacture of high-grade machinery and precision tools.

Original amount claimed: $1,119,357.32.

Final amount claimed: $949,858.82.

Amount finally allowed: $541,325.62.

Date of last determination: December 20, 1924.

Amortization deducted on value in use: $541,325.62.

Basis of last determination: Estimated sale value of retained facilities as of March 3, 1924.

Amount not based on solicitor's ruling: $541,325.62.

The above allowance was made as a result of a field examination on August 12 and 14, 1924, under the personal direction of the chief of the appraisal section. The following points should be noted in connection with this case:

(1) The pre-war, war, and postwar business of the taxpayer is the manufacture of high-grade machinery and precision tools, such as milling machines, screw machines, gear cutters, small tools, micrometers, gauges, reamers, etc. The war buiness of the taxpayer caused expansion for increased production of its regular line of business. Note the following quotation from the engineer's report:

"The taxpayer states that none of its war facilities have been abandoned but, on the contrary, all have been retained and used as required along with the prewar facilities in the going business."

It is then obvious that under this sytem the taxpayer will eventually wear out both his old pre-war equipment and his new war equipment, and thus he will suffer no ultimate loss by the purchase of the war equipment. The only loss is a loss of profit due to a premature investment. We believe a loss of profit is not contemplated in any possible way as a deduction from net income for tax purposes.

(2) The original claim was about double the amount finally allowed.

(3) The value in use percentage is based on a salvage value of the facilities amortized. A salvage value of 40 per cent is assigned to all items, regardless of their actual utility. It must be remembered that all facilities are retained in use, and that taxpayer uses his war facilities indiscriminately with his pre-war facilities, and has no intention of discarding any of these items. An allowance for depreciation due to use in a post war period is made. This depreciation is added to the salvage value to return the so-called residual value.

The value in use was computed both on the total labor hour-basis and the electric-power consumption basis, but these percentages were not used, because the engineer states "that mean value in use as computed above is less than the sale value of the plant plus depreciation for post war use." The value in use based on labor hours was 39.46 per cent. The value in use based on power consumption was 47 per cent. Below are shown the figures for electric-power consumption:

Electric-power consumption

	Kilowatt-hours		Kilowatt-hours
1913	2, 359, 475	1919	5, 948, 660
1914	3, 851, 190	1920	6, 865, 730
1915	2, 887, 513	1921	2, 597, 930
1916	5, 474, 120	1922	2, 884, 300
1917	6, 542, 410	1923	4, 082, 900
1918	7, 184, 520		

The above figures show that a rapid return to full operation of this business could be predicted from the power consumption in 1923. We do not believe the taxpayer will suffer any ultimate loss on the facilities he acquired during the war.

(4) The specific facilities of the taxpayer have not been examined. A salvage value of 40 per cent is applied to all items, although all of such items are retained in use. The engineer's report in this case was submitted on December 20, 1924, and was personally supervised in the field by the chief of appraisal section, yet this case is one of the most glaring instances of a direct violation of the solicitor's ruling of August, 1923.

(5) No investigation is made of the nature of postwar expenditures.

(6) The amortization is based on the difference between salvage value plus postwar depreciation and the war cost of the items. Under this system it can be seen that the unit gives the same value to a machine absolutely discarded as to the same kind of a machine which is 40 per cent in use. A proper value which takes into account both salvage value and useful value of the facilities is not made in this case.

(7) No investigation is made to determine whether war expenditures were in the nature of replacements or additions.

(8) The value-in-use percentage is applied to a "cost appraisal" less 1917 depreciation, as constructed by the American Appraisal Co. This cost appraisal as set up by the appraisal company, has allowed the cost of war facilities in a

special procedure which we have not found allowed in any other case. We do not understand why this company should not be obliged to furnish exact cost as all other companies are required to do, instead of using an appraisal to which considerable objection was taken by the audit division. As we have not a copy of the exact appraisal, we can not, however, discuss this subject fully.

MACHINERY MANUFACTURES

Name: Buda Co., Harvey, Ill.
Business: Manufacture of railroad supplies and combustion engines.
Original amount claimed: $280,721.77.
Final amount claimed: $955,554.50.
Amount finally allowed: $668,765.27.
Date of last determination: June 27, 1922.
Amortization deducted on value in use: $668,765.27.
Basis of last determination: Estimated sale or salvage value.
Amount not based on solicitor's ruling: $668,765.27.
The following points should be noted in connection with this allowance:

(1) Both the regular and war business of this taxpayer was the manufacture of internal-combustion engines. During the war the plant of the taxpayer was much extended for the manufacture of such engines. All the buildings and equipment of the taxpayer are retained in use.

(2) The original claim was only about 45 per cent of the amount finally allowed.

(3) The value-in-use percentage is claimed to be below the salvage value. The salvage value on all items of every description except buildings and building equipment is taken at 40 per cent of cost. The buildings and building equipment are only considered to be worth 25 per cent of cost.

(4) The amortization has not been determined from an examination of the value in use of each item but for all items grouped together (except buildings). This is plainly inaccurate and contrary to solicitor's ruling of August, 1923, and must be questioned. The amount allowed on buildings must also be questioned for reasons to be now stated.

The principal building on which amortization is allowed in the amount of 75 per cent of its cost, or an amount of $164,555.03, is described as below in the engineer's report:

"The building is a four-story and basement concrete structure of the most modern and improved type and is admirably suited to the taxpayer's needs for future expansion. Therefore, on the basis of its being a permanent plant betterment, a residual value of 25 per cent of its cost is arbitrarily assigned."

This building was partly occupied and in use, and in view of the above statement, we believe little ultimate loss could be suffered by the taxpayer.

(5) The nature of the postwar expenditures have not been investigated.

(6) Proper allowance is not made for salvage value in determining value in use.

(7) No investigation was made to determine whether war expenditures were for replacements or additions.

(8) Value-in-use percentage has been applied to war cost less 1917 depreciation.

IRON AND STEEL

Name: Camden Forge Co., Camden, N. J.
Business: Forge shop.
Original amount claimed: $816,536.09.
Final amount claimed: $1,434,334.74.
Amount finally allowed: $1,336,829.27.
Date of last determination: March 29, 1922.
Amortization deducted on property discarded or sold: $1,268,507.95.
Amortization deducted on value in use: $68,321.32.
Basis of last determination: Difference between cost and salvage values, also ratio of capacity to average postwar production for 1919, 1920, and 1921.
Amount based on solicitor's ruling and on sound engineering principles: $1,268,507.95.
Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $68,321.32.
The following points should be noted in connection with this allowance:

(1) The business of the taxpayer consists of a forge shop, the principal product of which, before the war, was railroad forgings. During the war the plant was greatly enlarged, for the production of marine forgings. The greater portion of

amortization is allowed on facilities discarded or sold, and such allowance is not questioned.

(2) The original claim of taxpayer was about two-thirds of the amount finally allowed.

(3) The value in use percentage is determined by the ratio of war capacity to average postwar production for the years 1919, 1920, and 1921.

(4) The amortization has not been computed for each specific facility, but the value in use of 50 per cent has been applied to all items retained in use. This is not in accordance with solicitor's ruling of August, 1923, and therefore must be questioned.

(5) It appears that there were no postwar expenditures worth considering at this plant.

(6) Proper allowance has not been made for the salvage value of those tems retained in use.

(7) No investigation is made to determine whether war expenditures were for replacements or additions.

(8) The value in use percentage has been applied to war cost less 1917 depreciation.

Name: Carbon Steel Co., Pittsburgh, Pa.
Business: Steel and steel products.
Original amount claimed: Not stated.
Final amount claimed: $1,854,089.74.
Amount finally allowed: $1,191,896.24.
Date of last determination: May 17, 1924.
Amortization deducted on property discarded or sold: $1,191,896.24.
Date of last determination: Difference between depreciated cost and sale or salvage value.
Amount based on solicitor's ruling and on sound engineering principles: $1,191,896.24.
NOTE.—The above allowance is not questioned.

SHIPPING

Name: Carib Steamship Co., New York, N. Y.
Business: Operating steamships.
Original amount claimed: $669,211.05.
Final amount claimed: $669,211.05.
Amount finally allowed: $664,211.05.
Date of last determination: No date given.
Amortization deducted on property discarded or sold: $664,211.05.
Basis of last determination: Difference between depreciated cost and sale price.
Amount based on solicitor's ruling and on sound engineering principles: $664,211.05.
NOTE.—The above allowance is not questioned.

IRON AND STEEL

Name: Central Steel Co., Massillon, Ohio.
Business: Steel ingots, billets, and castings.
Original amount claimed: $419,284.
Final amount claimed: $2,121,675.23.
Amount finally allowed: $1,571,391.35.
Date of last determination: December 17, 1922.
Amortization deducted on property discarded or sold: $172,171.40.
Amortization deducted on value in use: $1,399,219.95.
Basis of last determination: Postwar production and labor hours.
Amount based on solicitor's ruling and on sound engineering principles: $172,171.40.
Amount not based on solicitor's ruling: $1,399,219.95.
The following points should be noted in connection with this case:

(1) The normal business of this taxpayer consists in the manufacture of carbon and special alloy steels. Its war business was along the same lines as its pre-war business, only the capacity of the plant was increased to meet the extraordinary demands for the taxpayer's products. We are not questioning the allowances made on items which have been actually discarded by this company. It should

be noted that no allowance is made for reduced replacement costs in this case, as was done in the United States Steel Co. case and the Bethlehem Steel Co. case. This, of course, works to the disadvantage of the taxpayer.

(2) The taxpayer's original claim was less than 30 per cent of the amount finally allowed.

(3) Value in use percentage is really determined by direct estimate except in the case of miscellaneous machinery. Value in use for this item is determined by a comparison of the number of mill employees working in 1917 and 1918 to the number of mill employees working in 1921. This gives the value in use of 75 per cent. The figures showing number of employees are as follows:

Year	Number of mill employees	Number of office employees	Total	Year	Number of mill employees	Number of office employees	Total
1916	900	70	970	1919	1,501	286	1,787
1917	1,188	82	1,270	1920	1,610	148	1,758
1918	1,722	405	2,127	1921	1,000	177	1,177

It is obvious that this determination is based on the number of employees working in the year 1921, one of the worst years in the history of the steel industry. Figures for 1923 and 1924 are not given, but we are quite sure that they must have been considerably above that of 1921, unless this business is not in proportion with the rest of the industry. The engineer's report in this case contains the following statement:

"The allowances recommended in this schedule are more or less tentative and are subject to redetermination at the request of the taxpayer until March 3, 1924."

In view of the fact that the original examination in this case was made in a period of depression, and in view of the above statement, which acknowledges the tentative nature of the determination, we wonder why the commissioner has not ordered a complete reexamination of this case.

(4) The amortization has not been determined independently for each specific facility, although the different facilities are listed separately.

(5) Postwar expenditures in 1919 and 1920 amount to above $3,500,000. This expenditure is nearly as great as that made for war facilities during the years 1917, 1918, and 1919. However, no investigation has been made to show whether these postwar facilities were of a similar nature to those made during the war period, thus furnishing prima facie evidence that the taxpayer had full need for his war facilities.

(6) Proper allowance is not made for salvage value in determining the amortization on items retained in use.

(7) No investigation is made to determine whether war expenditures were in the nature of replacements or of additions.

(8) The value in use percentage has been applied to war costs less 1917 depreciation. No allowance is made for lowered postwar replacement costs, as has been allowed the large steel companies.

MINING

Name: Chile Copper Co., New York, N. Y.
Business: Mining and production of copper.
Original amount claimed: $4,313,223.24.
Final amount claimed: $4,313,223.24.
Amount finally allowed: $2,844,603.07.
Date of last determination: March 2, 1925.
Amortization deducted on reduced replacement costs: $2,844,603.07.
Basis of last determination: Difference between cost and depreciated normal postwar replacement costs.
Amount based on solicitor's ruling and on sound engineering principles: $2,844,603.07.

NOTE.—The above allowance is not questioned. The amortization on account of excessive labor costs during the war period looks extremely high, but sufficient details of computation are not given in the engineer's report for a determination on this point to be made.

SHIPPING

Name: China Mail Steamship Co. (Ltd.), San Francisco, Calif.
Business: Ocean transportation between Pacific coast ports and China.
Original amount claimed: None stated.
Final amount claimed: $1,530,502.50.
Amount finally allowed: $1,312,861.25.
Date of last determination: November 16, 1922.
Amortization deducted on reduced replacement costs: $1,312,861.25.
Basis of last determination: Difference between estimated replacement cost of vessel and actual cost.
Amount based on solicitor's ruling and on sound engineering principles: $1,312,861.25.
The above allowance is not questioned.

MINING

Name: Chino Copper Co., Hurley, N. Mex.
Business: Production and recovery of copper ores and conversion of same into concentrates for smelting.
Original amount claimed: $282,165.64.
Final amount claimed: $1,628,702.34.
Amount finally allowed: $1,107,086.14
Date of last determination: June 9, 1924.
Amortization deducted on property discarded or sold: $433,416.82.
Amortization deducted on value in use: $673,669.32.
Basis of last determination: Estimated "Base sale or salvage value," or on occupancy of houses.
Amount based on solicitor's ruling and on sound engineering principles: $433,416.82.
Amount not based on solicitor's ruling: $673,669.32.
The following points should be noted in connection with this allowance:
(1) The business of this taxpayer is the mining of copper by what is known as the open-pit process, which consists of a series of terraces upon which steam shovels are located for the removal of the ore. The amortization allowed on facilities actually discarded by this taxpayer is not questioned.
(2) The original claim was less than 30 per cent of the amount finally allowed.
(3) The value in use percentage as applied to the greater portion of the facilities is based on "An examination * * * of the present worth value of the entire mine plant for comparison with the value indicated on the basis of the market value of outstanding stocks during a pre-war, war, and postwar period, and values indicated by capitalized income-producing capacity of the operation. In the light of facts thus developed, a base residual value equivalent to 50 per cent has been adopted for the purpose of determining amortization allowable for tax purposes." In the case of certain housing facilities value in use has been determined by the ratio of houses occupied during the postwar period plus 10 per cent margin to the total number of houses constructed.
(4) Amortization is not determined for each specific facility as required by solicitor's ruling of August, 1923.
(5) The nature of postwar expenditures is not investigated.
(6) Proper allowance has not been made for salvage value in computing amortization on items retained in use.
(7) No investigation has been made to determine whether war expenditures were for replacements or for additions.
(8) The value in use per cent has been applied to war cost less 1917 depreciation.
(9) Amortization has been allowed for dwelling houses, which we do not concede to be a facility necessary for the prosecution of the war.

Name: Cleveland Cliffs Iron Co., Cleveland, Ohio.
Business: Mining of iron and coal. Hydroelectric power development, etc.
Original amount claimed: $900,180.44.
Final amount claimed: $4,156,210.27.
Amount finally allowed: $1,860,791.06.
Date of last determination: May 28, 1925.
Amortization deducted on property discarded or sold: $506,582.80.
Amortization deducted on reduced replacement costs: $303,623.21.

Amortization deducted on value in use: $1,050,585.05.

Basis of last determination: Difference in depreciated cost and discarded values. Ratio of war-time capacity to average postwar production for 1921, 1922, and 1923. Postwar occupancy of housing project.

Amount based on solicitor's ruling and on sound engineering principles: $810,206.01.

Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $1,050,585.05.

The following points should be noted in connection with this case:

(1) The corporation's business activities consists of iron, ore, and coal mining, lumbering, and the manufacture of various grades of pig iron and chemicals from pyroligneous acids.

We have not questioned amortization allowed on discarded facilities nor on the depreciated postwar replacement costs. We do not contend that the taxpayer has suffered no ultimate loss on facilities retained in use.

We wish to draw special attention to the statement in the engineer's report covering development costs on mines. This statement is as follows:

"The legal department of the Income Tax Unit during the month of April, 1925, ruled that mine development costs are not considered as coming within the scope of the statute referred to above amortization clause, and accordingly such development costs as were included in costs on which amortization was allowed in the report dated March 20, 1925, are disallowed in this supplemental report."

(2) The original claim of this taxpayer was about 50 per cent less than the amount finally allowed.

(3) The value in use percentage "is derived from average annual production compared to either actually proven or estimated capacity." The percentage in use as applied to the various departments vary from 50 per cent to 90 per cent. The postwar period includes the years 1921, 1922, and 1923.

(4) The amortization for each specific facility has not been determined, but the value in use percentage has been applied to the whole cost of plants or departments. This is not in accordance with solicitor's ruling of August, 1923.

(5) No investigation has been made as to the nature of postwar expenditures.

(6) Proper allowance has not been made for the salvage value of items retained in use.

(7) No investigation has been made to determine whether war expenditures were for replacements or additions.

(8) The value in use per cent has been applied to war cost less 1917 depreciation.

(9) While amortization is granted on lowered postwar replacement costs, the allowance is not made on the same item on both of the above grounds. It is specifically stated that lowered value in use and lowered postwar replacement can not be allowed on the same facility.

IRON AND STEEL

Colorado Fuel & Iron Co., Denver, Colo. (Also Colorado & Wyoming Railroad Co., subsidiary.)

Business: Recovery of coal, iron ore, limestone, and calcite; also manufacturing of steel and coal products.

Original amount claimed: $4,653,560.21.

Final amount claimed: $4,653,560.21.

Amount finally allowed: $2,959,432.75.

Date of last determination: January 12, 1923.

Amortization deducted on value in use: $2,959,432.75.

Basis of last determination: Ratio of average postwar use to war-time use, also salvage value.

Amount based on solicitor's ruling and on sound engineering principles: $365,323.75.

Amount not based on solicitor's ruling: $2,594,109.

The following points should be noted in connection with this allowance:

(1) This taxpayer is engaged in the recovery of basic natural resources, including coal, iron ore, limestone, calcite and the transportation and conversion of these materials.

During the war, extensive enlargements to its several plants became necessary in order that it might increase its production owing to the greatly increased demand for its products.

Taxpayer submitted claim for amortization in the sum of $4,653,560.21 on costs of $8,033,890.77.

The unit's engineer made a field examination of the facilities involved and submitted a report thereon in which he recommended amortization in the sum of $2,959,432.75 on costs of $7,575,582.54.

(2) The original claim for amortization was about 60 per cent in excess of the amount finally allowed.

(3) Value in use percentage is computed from the ratio of average production for the years 1921, 1922, and 1923 (estimated) to war capacity as indicated by actual war production. Different percentages are arrived at for the different lines of the taxpayer's business, such as steel manufacturing, mining, etc. Practically all facilities coming under steel manufacturing receive a value in use of 50 per cent.

(4) The value in use as stated above is applied to whole groups of facilities, and amortization is not computed for each item. This is therefore contrary to solicitor's ruling of August, 1923.

(5) No investigation has been made as to the nature of postwar expenditures, which might prove through the purchase of facilities similar to those acquired during the war that the war equipment was necessary.

(6) Proper allowance is not made for salvage value in computing the value of items retained in use.

(7) No investigation was made to determine whether the war expenditures were in the nature of replacements or of additions.

(8) The value in use percentage has been applied to war costs less 1917 depreciation.

(9) Amortization amounting to $131,565.98 has been allowed on the Colorado & Wyoming Railroad Co., whose stock is owned by this taxpayer. As pointed out in the hearings before the Senate committee, this allowance is illegal, and the bureau has acquiesced in this opinion. An unpublished ruling handed down in the case of the Sinclair Oil & Gas Co. denying amortization on pipe lines shows that the bureau has officially conceded that amortization is not allowable to "common carriers."

MUNITIONS

Name: Colts Patent Fire Arms Co., Hartford, Conn.

Business: Manufacture of firearms.

Original amount claimed: $2,871,036.92.

Final amount claimed: $6,734,144.25.

Amount finally allowed: $3,060,109.96.

Date of last determination: September 5, 1922.

Amortization deducted on property discarded or sold: $2,405,406.01.

Amortization deducted on value in use: $654,703.95.

Amount based on solicitor's ruling and on sound engineering principles: $2,405,406.01.

Amount not based on solicitor's ruling: $654,703.95.

The following points should be noted in connection with the above allowances:

(1) The taxpayer's regular business consisted of the manufacture of small firearms; during the war, however, large quantities of machine guns and machine rifles were produced. The greater portion of the facilities on which amortization was allowed were discarded and the allowance on that basis is not questioned. A certain amount of facilities of a nature standard to the taxpayer's business were retained in use.

(2) The original amortization claimed was slightly less than the amount finally allowed.

(3) The basis for determining the percentage in use of facilities is based upon a direct estimate of this percentage in use. In other words, on a practically unsubstantiated guess by the engineer. We are obliged to question this method.

(4) The specific facilities on which amortization was allowed were not examined to determine their individual useful value, but one percentage has been applied to entire departments or plants.

(5) No mention is made of the character of postwar expenditures, if any.

(6) Salvage value is not considered in determining residual value of items retained in use.

(7) No investigation was made to show whether war expenditures were for replacements or for additions.

(8) The value in use percentage is applied to estimated postwar replacement cost in care of buildings. Some other items were evidently considered to have a higher postwar replacement cost than the actual war cost; in this case the per cent in use was applied to war cost.

SHIPBUILDING

Name: Columbia River Shipbuilding Corporation, Portland, Oreg.
Business: Shipbuilding.
Original amount claimed: $1,101,717.99.
Final amount claimed: $1,101,717.99.
Amount finally allowed: $938,692.92.
Date of last determination: July 25, 1921.
Amortization deducted on property discarded and sold: $938,692.92.
Basis of last determination: Difference between depreciated costs and sales price.
Amount based on solicitor's ruling and on sound engineering principles: $938,692.92.
NOTE.—The above allowance is not questioned.

IRON AND STEEL

Name: Crucible Steel Co. of America, Pittsburgh, Pa.
Business: Steel products.
Original amount claimed: $659,000.
Final amount claimed: $10,924,025.52.
Amount finally allowed: $8,912,879.
Date of last determination: October 12, 1920.
Amortization deducted on value in use: $8,912,879.
Amount not based on solicitor's ruling: $8,912,879.
The following points should be noted in connection with this case:

(1) The taxpayer is a manufacturer of iron and steel, and during the war extended his plant facilities for the production of these products. We consider the amortization allowed in this case amounting to nearly $9,000,000, on costs of about $23,000,000, to have been based on a most inaccurate estimate at a time when the steel industry was at a very low ebb of production.

(2) The original claim in this case was about 80 per cent of the amount finally allowed.

(3) The value-in-use percentage was determined in some instances from the ratio of estimated normal postwar production to war-time capacity. In other cases, an arbitrary 10 per cent of costs was allowed and amortization to cover "excessive cost resulting from waste incident to haste and speed in construction."

(4) Amortization is not determined for each specific facility, but for whole plants or departments of plants.

(5) No investigation is made as to the nature of postwar expenditures. These expenditures for all plants as stated by the company were as follows:

	Amount
Apr. 6 to Dec. 31, 1917	$4, 718, 164. 40
Jan. 1 to Nov. 11, 1918	7, 729, 142. 92
Nov. 12 to Dec. 31, 1918	1, 592, 237. 61
Jan. 1 to Dec. 1, 1919	8, 491, 447. 64
Jan. 1 to Aug. 31, 1920	4, 794, 622. 04
Total	27, 325, 614. 61

As previously stated, amortization has been allowed on about $23,000,000 of the above costs, showing an exclusion of only $4,000,000 in the total costs. We believe it is evident from the above figures that the taxpayer has received entirely too much amortization on postwar expenditures. He claims he was committed to these expenditures as of November 11, 1918. It is perfectly evident from the nature of the facilities that cancellation of these commitments could have been made as of November 11, 1918, for an amount far less than the cost of completing these facilities. It is seen that over $14,000,000 was expended after the armistice, and that even if all of this was contracted for prior to November 11, 1918, liquidating damages on the above contracts would certainly not have exceeded 20 per cent of the cost shown.

(6) Proper allowance has not been made for salvage value in determining amortization on items retained in use.

(7) No investigation is made to determine whether the war expenditures were for replacements or additions. We do know that at the Midland plant of this taxpayer, he had an old blast furnace of 450 tons daily capacity. During the war he installed a new blast furnace of 600 tons daily capacity. This new furnace was of more economy and better construction than the old, still it has been averaged in with the old furnace as being the same relative value in determining value in use.

(8) Value in use percentage has been applied directly to war costs, without any allowance for 1917 depreciation or for postwar use.

GENERAL NOTE.—As stated above, we believe this amortization allowance to be one of the most inaccurate and approximate determinations which we have ever met with. In order to show this a little more clearly, we quote the following figures, which are practically all there is to this allowance:

Plant	War cost of facilities	Per cent allowed for amortization based on value in use	Amortization allowed
Midland plant:			
Heat-treating department	$735,905.44	75	$551,929.07
Appropriation Q (209)	144,262.14	30	43,278.64
2 open-hearth furnaces	489,496.69	42	205,588.61
Coal hoist and dock wall	347,085.29	39.5	137,098.69
By-product coke ovens	3,722,214.55	39.5	1,470,274.75
Boiler house extension	702,602.11	39.5	277,527.83
600-ton blast furnace, complete	3,206,434.23	45.2	1,449,308.27
Subtotal	9,348,000.45	....	4,135,005.86
Atha plant:			
Forge shop	2,209,502.18	80	1,767,601.74
Gas plant	817,316.68	70	572,121.07
Storage building	391,652.26	50	195,826.13
Item for shell plant	284,351.36	70	199,045.95
General items	3,989,364.56	10	398,936.45
Subtotal	7,692,187.04	....	3,133,531.94
Ordnance department, Atha Works	1,343,430.26	70	940,401.18
Park Works:			
Open-hearth furnaces	1,082,841.14	30	324,852.34
Electric furnaces	100,822.17	20	20,164.43
Oil tanks	42,271.95	50	21,135.97
General	366,257.41	10	36,625.74
Subtotal	1,592,192.67	....	402,778.48
Cayuga Works	624.68	10	62.47
Anderson Du Puy Works	6,177.44	10	617.74
Crescent Steel Co. Works	367,402.54	10	36,740.25
Sanderson Bros. Steel Works	905,054.13	10	90,505.41
Singer-Nimick Works	262,979.86	10	26,297.98
La Belle Works	151,621.53	10	15,162.15
Spaulding & Jennings Works	45,484.94	[1] 10	4,959.55
Halcomb Steel Co.	1,268,159.95	10	126,815.99
Grand total	22,983,315.49	....	8,912,879.00

[1] Approximate.

It can be seen from the above figures that very considerable allowances for amortization were made. The individual facilities of the taxpayer were not examined, but the percentages in use applied to either whole plants or departments of plants as shown.

We wish to draw special attention to the 10 per cent allowance made on a number of the above plants. This allowance was made not because the facilities were not in full use, but because of waste incident to haste and speed in construction. This does not seem to be a proper ground for amortization.

We also wish to draw attention to the fact that on September 29, 1920, the investigation of this taxpayer's claim, covering over $7,000,000 worth of physical assets was just started. Nine days after, or on October 7, 1920, the engineer's report was submitted. During these nine days, therefore, the engineer was supposed to check the allowance on the above amounts on physical assets located at numerous points in Pennsylvania, New York, and New Jersey. Fourteen different plants received amortization. Also the office work necessary to writing up this report had to be done within nine days. It appears, therefore, that there was extraordinary haste in computing the allowance of amortization to this taxpayer. It appears obvious that amortization can not be properly determined in any such length of time, when the facilities are practically all in use and the determination must be made on facts ascertained from the actual use of each facility.

FOODSTUFFS

Taxpayer: Cuban American Sugar Co., New York, N. Y.
Business: Production of raw sugar.
Original amount claimed: Not stated.
Final amount claimed: $2,742,612.86.
Amount finally allowed: $1,675,703.39.
Date of last determination: March 31, 1922.
Amortization deducted on value in use: $1,675,703.39.
Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $1,675,703.39.

The following points should be noted in connection with this allowance:

(1) This taxpayer is engaged in the business of planting and growing cane, purchasing cane from farmers, and the transportation of such cane to their local factory for the production of raw sugar. The company owns the stock of several subsidiary companies, all on the isle of Cuba, with the exception of one small company in Louisiana. The company also operates two refineries for handling the raw sugar, one in Cuba and one in Louisiana. Practically all of the facilities upon which amortization is claimed are retained in use.

(2) The original claim of this taxpayer is not stated in the papers at hand.

(3) The-value-in use percentage is obtained by a direct estimate by the bureau's engineers. A production basis is considered, but not used, as per the following quotation:

"A comparison of production of the years 1918 and 1919 with the postwar years 1920 and 1921 shows a value in use of approximately 79 per cent, but this was during an abnormal period and is not a true basis of the future business of the company.

"With the enormous tonnage of war sugar on the island of Cuba which is unsold, it is the opinion of the writer, this mill will not be used to capacity for years to come and an allowance of 40 per cent of cost on this equipment is considered reasonable and is allowed."

We believe from the above evidence it is obvious that the Commissioner of Internal Revenue should have ordered a reexamination of this case prior to March 3, 1924, as provided in the statutes.

(4) The specific facilities of the taxpayer have been listed, but the value in use is generally applied to groups of such facilities, which could not be considered in conformity with solicitor's ruling of August, 1923.

(5) No investigation was made as to the nature of postwar expenditures.

(6) Proper allowance has not been made for salvage value in determining amortization for items retained in use.

(7) No investigation has been made to determine whether war expenditures were for replacements or for additions.

(8) The value in use per cent has been applied to war cost less 1917 depreciation.

(9) Amortization in the amount of $579,572.70 has been allowed to the Chaparra Railroad Co., the subsidiary of the taxpayer. This allowance to a transportation company is a direct violation of the law, as now conceded by the bureau.

FOOD PRODUCTS

Taxpayer: Cudahy Packing Co., Chicago, Ill.
Business: Food packers.
Original amount claimed: $215,705.99.
Final amount claimed: $504,626.71.
Amount finally allowed: $500,360.13.
Date of last determination: November 21, 1921.
Amortization deducted on property discarded or sold: $113,701.29.
Amortization deducted on value in use, $386,658.84.
Basis of last determination: Difference between depreciated cost and sales price and scrap value, also estimated use value to taxpayer in postwar period.
Amount based on solicitor's ruling and on sound engineering principles: $113,701.29.
Amount not based on solicitor's ruling: $386,658.84.

The following points should be noted in connection with this allowance:

(1) Taxpayer is in the packing, canning, and cold-storage business. His plant was considerably enlarged during the war. The allowance on facilities discarded is not questioned, but on those facilities retained in use we believe taxpayer suffered no ultimate loss.

(2) The original amount claimed was only about 40 per cent of the amount finally allowed.

(3) Value in use is in general accepted as claimed by taxpayer. In general, the percentage appears to be based on the ratio of 1920 production to war capacity.

(4) The specific facilities of the taxpayer have not been examined as required by the solicitor's ruling of August, 1923.

(5) The nature of postwar expenditures has not been determined.

(6) Proper allowance has not been made for salvage value of items retained in use.

(7) No investigation has been made to determine whether war expenditures were for replacements or for additions.

(8) Value in use has been applied to war costs less 1917 depreciation.

CHEMICALS

Name: Diamond Alkali Co., Pittsburgh, Pa.
Business: Manufacture of alkali.
Original amount claimed: $586,537.71.
Final amount claimed: $1,756,453.64.
Amount finally allowed: $1,344,465.15.
Date of last determination: October 23, 1921.
Amortization deducted on value in use: $1,344,465.15.
Basis of last determination: Ratio of war-time capacity to postwar production.
Amount not based on solicitor's ruling: $1,344,465.15.

The following points should be noted in connection with this allowance:

(1) The taxpayer's business consists of manufacturing alkali. This alkali was used extensively during the war period in the manufacturing of explosives, benzols, T. N. T., etc. The allowances were based entirely upon items retained in use, and must be questioned inasmuch as it is not in accordance with solicitor's ruling of August, 1923.

(2) The original claim of the taxpayer was about 45 per cent of the amount finally allowed.

(3) The value in use percentage is taken as the ratio between average postwar production for 1919, 1920, and 1921 to war capacity. One value in use, namely, 56.63 per cent, has been applied to the total war expenditures to arrive at the value in use.

(4) The specific facilities of the taxpayer have not been examined.

(5) No investigation has been made as to the nature of postwar expenditures.

(6) Proper allowance has not been made for salvage value in computing value in use.

(7) No investigation has been made to determine whether war expenditures were for replacements or additions.

(8) The value in use per cent has been applied to war costs less 1917 depreciation.

SHIPPING

Name: Dollar Steamship Co., San Francisco, Calif.
Business: Shipping.
Original amount claimed: $536,990.69.
Final amount claimed: $721,958.44.
Amount finally allowed: $713,080.38.
Date of last determination: December 8, 1922.
Amortization deducted on reduced replacement costs: $713,080.38.
Basis of last determination: Difference between actual cost and estimated postwar replacement cost.
Amount based on solicitor's ruling and on sound engineering principles: $713,080.38.

NOTE.—We are unable to question this claim for lack of information. The amortization is allowed entirely on the difference between war cost and a depreciated replacement cost of $30 per dead-weight ton on the steam schooner *Stanley Dollar*.

It appears this vessel was built in 1912 and purchased by the taxpayer in September, 1917. The name of the seller is not given. If the seller was an American firm we do not see how the transfer of an old ship aided in prosecuting the war. On the other hand, a purchase from foreign interests might do so. t would also be interesting to know if seller paid a proper tax on sale of this ship to the Dollar Co. The vessel was in full use at time of examination.

SHIPBUILDING

Name: Doullut & Williams Shipbuilding Co. (Inc.), New Orleans, La.
Business: Shipbuilding.
Original amount claimed: Not stated.
Final amount claimed: $1,371,747.67.
Amount finally allowed: $1,241,720.53.
Date of last determination: March 2, 1923.
Amortization deducted on property discarded or sold: $1,241,720.53.
Basis of last determination: Difference between depreciated cost and sale price.
Amount based on solicitor's ruling and on sound engineering principles: $1,241,720.53.
NOTE.—The above allowance is not questioned.

Taxpayer: Downey Shipbuilding Co., Staten Island, N. Y.
Business: Shipbuilding.
Original amount claimed: $1,425,948.90.
Final amount claimed: $1,425,948.90.
Amount finally allowed: $1,270,991.78.
Date of last determination: December 16, 1921.
Amortization deducted on property discarded or sold: $357,967.61.
Amortization deducted on value in use: $913,024.17.
Basis of last determination: Difference between depreciated cost and sale or salvage value, and estimated use value in going business.
Amount based on solicitor's ruling and on sound engineering principles: $1,270,991.78.
Amount not based on solicitor's ruling: None.
Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: None.
NOTE.—While certain items are valued on a value in use basis, it appears the facilities were really out of use, and therefore we can not question this claim; in fact, it would appear that this taxpayer has not received as much amortization as others in the same condition.

Name: J. F. Duthie & Co., Seattle, Wash.
Business: Shipbuilding.
Original amount claimed: $1,142,615.61.
Final amount claimed: $1,142,615.61.
Amount finally allowed: $707,972.78.
Date of last determination: August 12, 1921.
Amortization deducted on property discarded or sold: $707,972.78.
Basis of last determination: Difference between depreciated cost and sales price.
Amount based on solicitor's ruling and on sound engineering principles: $707,972.78.
NOTE.—The above allowance has not been questioned.

MUNITIONS

Name: E. I. du Pont de Nemours & Co., Wilmington, Del.
Business: Manufacture of explosives and war munitions; also dyes, chemicals, paints, etc.
Original amount claimed: Not determined.
Final amount claimed: $17,246,224.45.
Amount finally allowed: $15,369,123.55.
Date of last determination: May 24, 1923.
Amortization deducted on property discarded and sold: $15,204,780.49.
Amortization deducted on value in use: $164,343.06.
Basis of last determination: Difference between depreciated cost and sales price or estimated sale value; also estimated use to taxpayer in postwar business.
Amount based on solicitor's ruling and on sound engineering principles: $15,204,780.49.
Amount not based on solicitor's ruling, $164,343.06.
The following points should be noted in this case:
(1) The taxpayer did an enormous excess business during the war period in all kinds of explosives. Nearly all the amortization is on the basis of difference in cost and discarded or sale value. The method of arriving at original costs is condemend, but we have not questioned the amount allowed on discarded value.

It appears that the costs are really set up on the basis of a retrospective appraisal. This opportunity is not accorded other taxpayers and under this sytem there is grave danger of inclusion of expenditures or commitments prior to April 6, 1917.

(2) The original claim on amortization, distinguished from loss of useful value and obsolescence has not been determined.

(3) The value in use of facilities is by direct estimate in most cases, or on estimate of floor space occupied in case of buildings.

(4) Specific facilities have not been examined to any extent.

(5) Postwar expenditures have not been studied.

(6) Salvage value of items retained in use has not been given due weight.

(7) Replacements as distinguished from additions have not been shown.

(8) The value-in-use percentage is applied to "constructed" war costs less 1917 depreciation.

MUNITIONS

Name: Eddystone Munitions Co., Eddystone, Pa.

Business: Manufacture of cartridge cases, projectors, 6-inch shells, etc.

Original amount claimed: $1,757,350.21.

Final amount claimed: $1,595,179.37.

Amount finally allowed: $1,595,179.37.

Date of last determination: June 19, 1923.

Amortization deducted on property discarded and sold: $1,595,179.37.

Amount based on solicitor's ruling and on sound engineering principles: $1,595,179.37.

NOTE.—This case is all based on sales price and is not questioned.

IRON AND STEEL

Name: Edgewater Steel Co., Oakmont, Pa.

Business: Manufacture of steel and steel products; also field guns and steel wheels.

Original amount claimed: $448,304.71.

Final amount claimed: $951,848.98.

Amount finally allowed: $700,817.37.

Date of last determination: December 18, 1922.

Amortization deducted on property discarded or sold: $36,525.35.

Amortization deducted on reduced replacement costs: $435,759.42.

Amortization deducted on value in use: $228,532.60.

Basis of last determination: Difference between depreciated cost and sale price or salvage value. Estimated residual values.

Amount based on solicitor's ruling and on sound engineering principles: $472,284.77.

Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $228,532.60.

NOTE.—The following points should be noted in connection with this allowance:

(1) The regular products of this company are rolled-steel work, wheels, and locomotive tires. During the war the taxpayer manufactured gun forgings, and numerous castings for the Shipping Board. The report of Engineer Seabright contains the following quotation:

"Practically all the equipment installed during the war is retained by the Edgewater Steel Co. and used to full capacity. In checking the schedule submitted by them there are only a few items which are not being used at the present time."

On December 18, 1922, a report on the reexamination of the claim of this taxpayer was made. This report sets up the usual basis of obtaining value in use.

(2) The original claim of this taxpayer was only about 65 per cent of the amount finally allowed.

(3) The value in use percentage is in general a direct estimate of the engineer based either on a consideration of the salvage value of the item or of its relative postwar productivity. The capacity of the open hearth furnace of this taxpayer is stated to be approximately 42,000 tons per year. The actual production figures follow:

	Ton		Ton
1916	None.	1920	29,767
1917	19,134	1921	3,303
1918	18,043	1922	27,005
1919	18,585		

It can be seen from the above figures that the 1923 production is not given, but the 1922 production gives every promise of a return to business conditions which will require full capacity of the taxpayer's plant.

(4) The specific facilities of the taxpayer appear to have been examined in this case.

(5) No investigation has been made as to the nature of postwar expenditures. It might be noted in this connection that during the war the Government erected upon the taxpayer's property a 35-ton open-hearth furnace. The taxpayer purchased this furnace from the Government subsequent to the war. In spite of this fact the taxpayer has been allowed 66⅔ per cent amortization upon a 75-ton furnace which he constructed during the war.

(6) Proper allowance has not been made for the salvage value of items retained in use.

(7) No investigation has been made to determine whether war expenditures were for replacements or for additions.

(8) The value in use percentage has been applied to depreciated postwar replacement cost.

IRON AND STEEL

Name: Erie Forge Co., Erie, Pa.

Business: Ingots, heavy forgings, submarine crank shafts, connecting rods, etc

Original amount claimed: $1,265,306.08.

Final amount claimed: $1,265,306.08.

Amount finally allowed: $1,132,354.33.

Date of last determination: December 6, 1921.

Amortization deducted on property discarded or sold: $360,140.13.

Amortization deducted on value in use: $772,214.20.

Basis of last determination: Difference between depreciated cost and sales price or discarded salvage value, also ratio of average monthly production during war period and that from January 1, 1919, to April 30, 1921.

Amount based on solicitor's ruling and on sound engineering principles: $360,140.13.

Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $772,214.20.

The following points should be noted in connection with this allowance:

(1) The business of the taxpayer consists in the manufacture of ingots and heavy steel forgings. A considerable amount of war work was performed. The amortization allowed on the discarded facilities is not questioned, but it is believed that this taxpayer has suffered no ultimate loss on those facilities retained in use.

(2) The original claim of the taxpayer was about 10 per cent of the amount finally allowed.

(3) The value in use percentage is taken as a ratio of average monthly production from January 1, 1919, to May 1, 1921, to average monthly production during the war period. One percentage in use, namely, 34 per cent has been applied to the cost of all facilities retained in use. This method is contrary to the solicitor's ruling of August, 1923, and must be questioned.

(4) The amortization has not been computed for each specific facility of the taxpayer.

(5) No investigation has been made as to the nature of postwar expenditures.

(6) Proper allowance has not been made for the salvage value of items retained in use.

(7) No investigation has been made to determine whether war expenditures were for replacements or for additions.

(8) The value in use per cent has been applied to war costs less 1917 depreciation.

MUNITIONS

Name: Evans Engineering Co., New York, N. Y.

Business: Loading shells for Government.

Original amount claimed: $812,863.73.

Final amount claimed: $812,863.73.

Amount finally allowed: $512,401.85.

Date of last determination: July 9, 1920.

Amortization deducted on property discarded or sold: $512,401.85.

Basis of last determination: Difference between actual costs and amount received from sale to Government.

Amount based on solicitor's ruling and on sound engineering principles: $512,401.85.

NOTE.—The allowance has not been questioned as it is based on actual sales price. The taxpayer was in the munitions business only.

TIRE AND RUBBER GOODS

Name: Firestone Tire Co., Akron, Ohio.
Business: Manufacture of tires and rubber goods.
Original amount claimed: Not given.
Final amount claimed: $3,950,679.61.
Amount finally allowed: $2,016,194.30.
Date of last determination: December 9, 1922.
Amortization deducted on property discarded or sold: $551,210.57.
Amortization deducted on reduced replacement costs: None.
Amortization deducted on value in use: $1,464,983.73.
Basis of last determination: Difference between depreciated costs and sales price or salvage value, also ratio of war-time capacity to postwar production.
Amount based on solicitor's ruling and on sound engineering principles: $551,210.57.
Amount not based on solicitor's ruling: $1,464,983.73.
Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: None.

NOTE.—The following points should be noted in connection with this allowance:

(1) The normal business of taxpayer is the manufacture of rubber tires and steel rims and accessories. During the war period it also produced certain specialties, such as gas masks, balloon fabrics, etc. Amortization is allowed on all war expenditures, whether for tires of for specialties. No reduction in the allowance is made for the fact that a considerable portion of the facilities were purchased for the manufacture of tires for pleasure automobiles. As usual we have not questioned the allowance made on facilities discarded or sold.

(2) The original claim was about double the amount finally allowed.

(3) The value in use percentage is based on the ratio of the average monthly production for the three highest months in 1921, 1922 and 1923 (estimated), to the war capacity for a three months period. This percentage was first fixed at 78 per cent and later reduced to 74 per cent on complaint of taxpayer.

The absence of real loss to the taxpayer on facilities retained in use can be seen from the following quotation covering the most important plant of the taxpayer.

"Plant No. 2, Volume VI; cost, $2,551,974.59: This is a new and fully equipped plant erected in 1917 and 1918. It is equipped for the manufacture of the smaller sizes of tires. As a unit for the production of these it did not come into full use during the war, but was used for other war work as previously explained. At the time of the engineer's visit this plant was in use to practically full capacity, two shifts a day, and it is reasonable to suppose that approximately similar conditions have existed in the past and will exist in the future during the busy season.

"These conditions indicate that the floor space in this plant is somewhat in excess of the present needs. On the other hand it must be considered that this plant is busy for two shifts out of three each day during the busy season. It is not contended that the building is as full of machinery as might be possible, but it is believed that it is nearly as full as is practicable, if it is desired to have a light, clean, well ventilated plant. It may not be necessary to store tires or rubber in the building, but it is a convenience, and conveniences have a value.

"On one point there is no doubt. Plant 2 is a permanent improvement. It may have unused capacity for one-third of the time, but it is a well equipped and laid out piece of machinery for manufacturing fabric tires. The handling costs are kept at a minimum, and as compared with plant 1 it shows the difference between a plant which has been designed for a definite purpose with the experience of a number of years behind it, and a plant which has grown up by additions and rearrangements through a number of years. The taxpayer has applied a general activity ratio to this facility as a whole and has further insisted that both plants No. 1 and No. 2 be treated as a whole. This method of application is conceded to be reasonable, and an amortization of 22 per cent of cost is recommended on the total cost of plant No. 2."

It should be noted in regard to the above that the percentage of amortization allowed was increased to 26 per cent in a later report. We see no justification on the engineer's own statement for any lowered value in use at all on this plant.

(4) The amortization has not been computed on individual items except in a few instances. The one value in use per cent as outlined in point (3) has been used on the great majority of facilities.

(5) No investigation has been made as to the nature of postwar expenditures except as follows:

One of the most important and most expensive machines in rubber manufacture is known as a "massing machine." Of these machines the taxpayer had 55 before the war; during the war or amortization period he purchased 21 more of these machines. After the amortization period he purchased and installed 18 similar machines. Now, although the purchase of these 18 machines in the postwar period should have been conclusive that he needed for his normal business the 21 installed during the war, the taxpayer is nevertheless allowed 26 per cent amortization on these 21 machines.

(6) Proper allowance has not been made for the salvage value of items retained in use.

(7) No investigation has been made to determine whether war expenditures were for replacements or for additions.

(8) Value in use percentage has been applied to war cost less 1917 depreciation.

SHIPBUILDING

Name: W. & A. Fletcher Co., Hoboken, N. J.
Business: Shipbuilding.
Original amount claimed: $1,456,245.56.
Final amount claimed: $1,456,245.56.
Amount finally allowed: $529,574.63.
Date of last determination: July 26, 1923.
Amortization deducted on value in use: $529,574.63.
Basis of last determination: Estimated residual values based on ratio of number of employees during war-time period and postwar period.
Amount not based on solicitor's ruling: $529,574.63.

NOTE.—The following points should be noted in connection with this allowance:

(1) The taxpayer is in the business of ship repairing and boiler manufacturing. Both his prewar, war, and postwar business was of similar character. The facilities amortized consist principally of joiner shop, plate shop, and machine shop equipment and buildings. The amortization is all based on the value in use.

(2) The original claim of this taxpayer was about three times the amount finally allowed.

(3) The value in use percentage is the ratio of the average number of employees during 1921 and 1922 to the number of employees in 1919. We contend that the taxpayer's business being principally repair work, it is of a nature to require the facilities upon which amortization has been allowed. It can not be expected that in a normal or postwar period all facilities which are necessary occasionally in repair work are going to be kept operating in full capacity. However, such facilities are absolutely necessary in the postwar business of the taxpayer in order for him to perform the intermittent work that may be required. We do not believe that the taxpayer has suffered any ultimate loss on these facilities.

(4) Amortization has not been computed for each specific facility, but one value in use, namely, 33⅓ per cent has been used.

(5) No investigation has been made as to the nature of postwar expenditures.

(6) Proper allowance is not made for the salvage value of those items retained in use.

(7) No investigation has been made to determine whether war expenditures were for replacements or for additions.

(8) The value in use percentage has been applied to war cost less 1917 depreciation.

GENERAL NOTE.—The history of this case as shown by the engineer's reports is interesting. The case was first examined by Engineers Clack and Lenox, who submitted a report on this claim on October 7, 1922. They recommended an amortization allowance of $317,312. In the matter of those costs, which should be amortized subsequent to the ending of the war period, the engineers determined that 34 per cent of the work performed by the taxpayer in 1919 consisted of war work, and that the rest was ordinary commercial work. Therefore, they allowed the taxpayer amortization of 34 per cent of his 1919 expenditures.

On March 31, 1923, Mr. Clack, one of the original engineers, made an office report on this case and raised the amortization allowance from the $317,312 mentioned above, to $460,231. This change is arrived at by allowing 70 per cent of the 1919 expenditures as amortizable instead of the 34 per cent as allowed in the original report.

On July 26, 1923, Mr. Clack submitted a second office redetermination of this claim. The final allowance is now raised to $529,574. This is arrived at by allowing amortization on all 1919 expenditures.

This shows how successive office determinations can raise an amortization allowance over $200,000, or nearly 75 per cent. We wonder why the taxpayer did not protest at least twice more, as he would have had a good chance, apparently, to find some basis upon which he could have still raised his allowance by $200,000 more.

MACHINERY AND TOOLS

Name: Ford Motor Co., Highland Park, Mich.
Business: Manufacture of motor cars, tractors, tanks, etc.
Original amount claimed: $4,464,277.67.
Final amount claimed: $1,863,845.88.
Amount finally allowed: $1,089,072.11.
Date of last determination: July 24, 1922.
Amortization deducted on property discarded or sold: $371,264.65.
Amortization deducted on reduced replacement costs: $297,640.82.
Amortization deducted on value in use: $420,166.64.

Basis of last determination: Difference between cost and sales price or salvage value; also estimated postwar use to taxpayer in going business.

Amount based on solicitor's ruling and on sound engineering principles: $668,905.47.

Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $420,166.64.

NOTE.—We contend that no ultimate loss has been suffered by taxpayer in this case on lowered value in use. It is true, however, that this taxpayer could have undoubtedly received larger allowances under the head of reduced postwar replacement costs if same had been claimed.

CHEMICALS

Name: General Chemical Co., New York, N. Y.
Business: Manufacture of chemicals.
Original amount claimed: $1,815,598.60.
Final amount claimed: $4,092,895.45.
Amount finally allowed: $3,110,102.92.
Date of last determination: January 7, 1925.
Amortization deducted on property discarded or sold: $1,713,926.01.
Amortization deducted on value in use: $1,396,176.91.

Basis of last determination: Difference between depreciated cost and sale price or salvage values, estimated excess capacity, and estimated residual value.

Amount based on solicitor's ruling and on sound engineering principles: $1,713,926.01.

Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $1,396,176.91.

The following points should be noted in connection with this allowance:

(1) The facilities of the taxpayer on which amortization is claimed consist of general plant installations and machinery necessary for the production of various chemicals, among which the following appear to be most important: Sulphuric acid, muriatic acid, trisodium sulphate, sodium hyposulphite, sodium aluminum sulphate, anhydrous bisulphite of soda, insecticides, soda lime, nitric acid, acetic acid, sodium sulphide, sodium silicate, Ryson (baking powder), sulphate of alumina, acetic anhydride, and sodium and postasium permanganates.

During the war period it is evident that a large use was made in munition manufacture of the sulphuric, nitric, and other acids produced by the taxpayer. Considerable plant expansions were made.

Over half of the allowance for amortization in this case is on facilities which are discarded. This allowance we do not question, although it is true that many of the items have not been sold and are available for use if the taxpayer's business should require same.

A study of the production of the taxpayer's plants shows a depression in 1921 and 1922, but in 1923 many of the products which he produces were manufactured in greater quantities than ever before in the history of his business, not even excluding the war period. It is our opinion that the taxpayer has suffered no ultimate loss as of March 3, 1924, on the facilities retained in use.

(2) The original claim was only about 60 per cent of the amount finally allowed.

(3) The basis of value in use is an estimated percentage arrived at as proper in the judgment of the engineer after considering 1921, 1922, and 1923 productions.

(4) The value in use has in general been arrived at by reducing the cost of groups of items a certain percentage. It is not a method, therefore, exactly in accord with the solicitor's ruling of August 19, 1923, although the grouping is more sound than in the majority of amortization allowances.

(5) There is no mention in the engineer's report of any investigation of postwar expenditures for facilities of a similar nature to those installed in the war period, as required by the solicitor's ruling.

(6) Due weight has not been given to the salvage value of items retained in use.

(7) No consideration is given to the matter of whether the war expenditures were for replacements or additions.

(8) The value in use percentage is applied to war cost less 1917 depreciation.

MACHINERY MANUFACTURING

Name: General Electric Co., Schenectady, N. Y.
Business: Manufacture of electrical equipment.
Original amount claimed: $9,075,180.89.
Final amount claimed: $6,508,432.85.
Amount finally allowed: $3,249,367.49.
Date of last determination: March 18, 1925.
Amortization deducted on property discarded or sold: $1,391,702.58.
Amortization deducted on reduced replacement costs: $670,304.39.
Amortization deducted on value in use: $1,187,360.52.

Basis of last determination: Difference between depreciated cost and discarded value, ratio of activity as indicated by man-hours employed for war-time and postwar period.

Amount based on solicitor's ruling and on sound engineering principles: $2,062,006.97.

Amount not based on solicitor's ruling: $1,187,360.52.

The following points should be noted in connection with this allowance:

(1) This taxpayer is the largest manufacturer of electric machinery and appliances in the world. We do not take exception to allowances based on lowered replacement cost or discarded value. We do contend that the taxpayer has suffered no ultimate loss from facilities retained in use.

(2) The original claim was nearly three times the amount finally allowed.

(3) The value-in-use percentage has been determined from the ratio between average number of employees in 1921, 1922, and 1923, and the number of employees in 1918. It should be noted that the figures show for 1923 only that the activity of the plants was as great as in 1918.

(4) The specific facilities have not been examined but amortization is obtained by one value-in-use per cent for an entire plant.

(5) The taxpayer has given evidence of his need for his war facilities by expenditures in postwar facilities of a similar character, but this is not taken into account by the bureau.

Six new plants have been installed by the taxpayer since the war period. At least two of the new plants are admitted to be for the manufacture of products similar to those manufactured at the plants on which lowered value in use is allowed. We can not agree that the bureau should have given any amortization on such facilities.

It is further stated in the engineer's report that "all of the taxpayer's plants were operating to capacity during 1923."

We must question, therefore, the propriety of allowances for lowered value in use.

(6) Proper allowance has not been made for the salvage value of items retained in use.

(7) No investigation has been made to determine whether war expenditures were for replacements or for additions.

(8) The value-in-use percentage is applied to war cost less 1917 depreciation. Both lowered replacement cost and lowered value in use is specifically denied on the same items.

General Note.—Reference is made in this report to a ruling made by the solicitor disallowing amortization in the case of a subsidiary housing company.

SHIPBUILDING

Name: Globe Shipbuilding Co., Superior, Wis.

Business: Shipbuilding.

Original amount claimed: $125,945.05.

Final amount claimed: $869,705.50.

Amount finally allowed: $646,850.43.

Date of last determination: June 27, 1922.

Amortization deducted on property discarded or sold: $567,238.89.

Amortization deducted on value in use: $79,611.54.

Basis of last determination: Difference between costs and sales price also estimated residual value.

Amount based on solicitor's ruling and on sound engineering principles: $646,850.43.

Note.—This allowance has not been questioned.

MUNITIONS

Name: Gorham Manufacturing Co., Providence, R. I.

Business: Manufacture of small cups, cartridge cases, hand grenades, Navy caliber cases, etc.

Original amount claimed: $521,700.60.

Final amount claimed: $614,498.40.

Amount finally allowed: $594,636.72.

Date of last determination: November 13, 1923.

Amortization deducted on property discarded or sold: $505,018.31.

Amortization deducted on reduced replacement costs: None.

Amortization deducted on value in use (residual value): $89,618.41.

Basis of last determination: Difference between costs and sales price plus depreciation, also residual value or sales value.

Amount based on solicitor's ruling and on sound engineering principles: $594,636.72.

Note.—This taxpayer's regular business is that of manufacturing silverware. During the war period, however, it engaged in the manufacture of cartridge cases, bullet jackets, cups, hand grenades, Navy caliber cases, trench bombs, and various other smaller articles essential to the prosecution of the war. During the war period the superintendent of the Gorham plant was Capt. Otho V. Kean, a graduate of West Point. It is believed that it was through his efforts that the company engaged in manufacturing war essentials. Taxpayer's claim was divided in six separate parts, only three of which are considered in this report, the other three having been treated separately under the name of the Silversmiths Co., of Fifth Avenue, New York City.

The first mentioned three parts are as follows: (1) Eddy Street plant, (2) Phillipsdale plant, and (3) Gorham plant.

The Eddy Street plant and the Phillipsdale plant were strictly war-time plants and were sold or discarded after the war contracts had been terminated. The engineer has allowed amortization in a sum equal to the difference of depreciated costs and sale price. This is perfectly regular and in keeping with the regulations of the unit.

In the case of the Gorham plant certain facilities were retained and these were amortized on a basis of residual or sales value. This also is considered proper.

The only questionable feature in this case is the sale of the Phillipsdale plant to Captain Kean, superintendent of the taxpayer. This plant cost $350,667.49 and was sold to Captain Kean for $75,000, or about 20 per cent of the cost. This price appears to be extremely low but it must be admitted that there is not sufficient data at hand upon which to express an intelligent opinion.

The allowance made has not, therefore, been questioned in our summation of amortization allowances.

SHIPPING

Name: W. R. Grace & Co., New York, N. Y.
Business: Exporting and importing, also nitrate properties.
Original amount claimed: $437,715.
Final amount claimed: $3,860,539.68.
Amount finally allowed: $2,158,500.60.
Date of last determination: February 4, 1925.
Amortization deducted on reduced replacement costs: $1,886,140.02.
Amortization deducted on value in use: $272,360.58.
Basis of last determination: Postwar production as compared with production during the time the Government contracts were being completed.
Amount based on solicitor's ruling and on sound engineering principles: $1,374,816.44.
Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $783,684.16.
NOTE.—The principal objection to the allowance noted above is to the amortization of vessels contracted for prior to April 6, 1917.
Amortization has been allowed on the steamship *Santa Ana* in the amount of $239,894.60. This vessel was contracted for from William Cramp & Sons on February 24, 1916. We can not concede that this vessel was purchased for war purposes on account of this contract for its construction over one year before the war was declared.
The *Santa Luisa* was a sister ship of the *Santa Ana* and contracted for on the same date. We question the amortization allowance on this ship amounting to $271,428.88.

SHIPBUILDING

Name: Great Lakes Engineering Co., Detroit, Mich.
Business: Steel ship construction.
Original amount claimed: None stated.
Final amount claimed: $2,142,277.21.
Amount finally allowed: $1,700,712.16.
Date of last determination: May 11, 1922.
Amortization deducted on property discarded or sold: $1,700,712.16.
Basis of last determination: Difference between costs and sale price.
Amount based on solicitor's ruling and on sound engineering principles: $1,700,712.16.
NOTE.—This allowance based on actual sale price is not questioned.

IRON AND STEEL

Name: The Hamilton Furnace Co., Hamilton, Ohio.
Business: Production of pig iron.
Original amount claimed: $1,128,181.16.
Final amount claimed: $1,128,181.16.
Amount finally allowed: $769,904.65.
Date of last determination: June 14, 1921.
Amortization deducted on value in use: $769,904.65.
Basis of last determination: Ratio of war-time capacity to postwar production, also an estimated residual value of retained facilities.
Amount not based on solicitor's ruling: $769,904.65.
NOTE.—The value in use percentage is determined for the whole plant on a production basis. The 1922 and 1923 production figures were not available. No data exists showing that taxpayer took any ultimate loss on his facilities installed during the war.

SHIPBUILDING

Name: Hanlon Dry Dock & Ship Building Co., Oakland, Calif.
Business: General ship repair work.
Original amount claimed: $408,833.41.
Final amount claimed: $961,382.20.
Amount finally allowed: $914,934.39.
Date of last determination: November 13, 1922.
Amortization deducted on property discarded or sold: $885,999.10.
Amortization deducted on value in use: $28,935.29.

Basis of last determination: Difference between costs and estimated future sale price and ratio of war-time and postwar occupancy.

Amount based on solicitor's ruling and on sound engineering principles: $885,999.10.

Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $28,935.29.

NOTE.—Only a very small amount of amortization is questioned in this case. The taxpayer is considered to have suffered no ultimate loss on facilities retained in use. In view of our other reports, this item need not be discussed.

MACHINERY MANUFACTURERS

Name: Heppenstall Forge & Knife Co., Pittsburgh, Pa.

Business. Manufacture of forgings and shear knives.

Original amount claimed: $679,220.68.

Final amount claimed: $955,678.23.

Amount finally allowed: $899,387.44.

Date of last determination: October 27, 1923.

Amortization deducted on property discarded or sold: $279,808.53.

Amortization deducted on value in use: $619,578.91.

Basis of last determination: Ratio of war-time capacity to average postwar production.

Amount based on solicitor's ruling and on sound engineering principles: $279,808.53.

Amount not based on solicitor's ruling: $619,578.91.

The following points should be noted in connection with this allowance:

(1) Taxpayer's normal and war business is the manufacture of steel forgings and shear knives. We have not questioned the allowance on discarded facilities, but we believe the taxpayer has suffered no loss on the items retained in use, as his 1923 business was nearly equal in volume to his war business.

(2) The original claim of this taxpayer is about 75 per cent of the amount finally allowed.

(3) The value-in-use percentage is the ratio of average 1921, 1922, and 1923 production to war capacity.

(4) The specific facilities of the taxpayer have not been examined as required by solicitor's ruling of August, 1923.

(5) No investigation has been made as to the nature of postwar expenditures.

(6) Proper allowance has not been made for the salvage value of items retained in use.

(7) No investigation has been made to determine whether war expenditures were for replacements or for additions.

(8) The value-in-use percentage has been applied to war cost less 1917 depreciation.

IRON AND STEEL

Name: Hydraulic Pressed Steel Co., Cleveland, Ohio.

Business: Pressed steel manufacturer, automobile frames, etc.

Original amount claimed: None stated.

Final amount claimed: $3,582,924.83.

Amount finally allowed: $1,854,650.05.

Date of last determination: September 29, 1924.

Amortization deducted on property discarded or sold: $1,461,894.65.

Amortization deducted on value in use: $392,755.40.

Basis of last determination: Difference between depreciated cost and sales price or salvage value; also estimated residual values.

Amount based on solicitor's ruling and on sound engineering principles: $1,461,894.65.

Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $392,755.40.

NOTE.—The allowance for reduced value in use is the only amount questioned. It appears that the value in use is in general taken as the salvage value. This method we consider indefensible.

MACHINERY MANUFACTURING

Name: Ingersoll Rand Co., New York, N. Y.

Business: Manufacture of shells, forgings, and air-driven equipment.

Original amount claimed: $254,494.50.

Final amount claimed: $2,324,323.44.
Amount finally allowed: $829,320.33.
Date of last determination: March 3, 1925.
Amortization deducted on property discarded or sold: $260,192.25.
Amortization deducted on value in use: $569,128.08.
Basis of last determination: Ratio of war-time capacity to average postwar production based on productive labor hours, weights, and labor costs.
Amount based on solicitor's ruling and on sound engineering principles: $260,192.25.
Amount not based on solicitor's ruling: $569,128.08.
The following points should be noted in this allowance:

1. The taxpayer's normal business of manufacturing compressors, air tools, drills, blowers, pumps, etc., was of such a character as to receive a large amount of war business from shipyards, munitions plants, and other war industries. In addition to this the taxpayer manufactured shells for the United States. Inasmuch as the facilities used in the manufacture of shells were discarded, we have not questioned this portion of the allowance, amounting to $260,192.25. The remainder of the allowance is all based on value in use of items retained in the taxpayer's regular postwar business. We do question this allowance.
2. The original claim of taxpayer was only about 30 per cent of the amount finally allowed.
3. The basis of value in use is the ratio between war capacity and average postwar production for 1921, 1922, and 1923, due allowance being made for overtime work during the war period which abnormally increased production. An examination of the production figures shows that the taxpayer's business was poor in 1921 and 1922 but good in 1923. In fact, the 1923 production for a normal one shift per day was in general more than the war production for one shift a day. In our opinion the taxpayer suffered no ultimate loss due to lowered value in use as of March 3, 1924.
4. The amortization has not been determined for each specific facility but by whole departments of each plant. This in spite of the fact that this engineer's report was submitted March 3, 1925, or over one and one-half years after the solicitor's ruling was made condemning the practice.
5. The solicitor's ruling has also been knowingly disregarded by allowing amortization on items of a character similar to those installed after the conclusion of the war period. The purchase of these items in the postwar period furnished prima facie evidence that the facilities installed during the war were needed. The engineer states that an addition of considerable size was made to the compressor plant at Phillipsburg in 1923, and also that a considerable amount of overtime work was put in at this plant in 1923. In face of these facts, he grants an allowance for amortization on the compressor plant of 26 per cent. It appears obvious that no such allowance should have been made.
6. Due weight has not been given to the salvage value of items retained in use.
7. No investigation was made to determine whether the war expenditures were in the nature of replacements or of additions.
8. The value-in-use percentage is applied to war cost less 1917 depreciation. Allowances on basis of lowered replacement costs are not made.

Name: International Harvester Co., Chicago, Ill.
Business: Manufacture of various farming implements and machines; also machine-gun carts, etc.
Original amount claimed: $1,567,811.42.
Final amount claimed: $4,300,597.99.
Amount finally allowed: $3,716,284.20.
Date of last determination: August 3, 1922.
Amortization deducted on reduced replacement costs: $1,586,068.92.
Amortization deducted on value in use: $2,130,215.28.
Basis of last determination: Difference between war time and postwar replacement costs (depreciated); also production basis for items retained in use.
Amount based on solicitor's ruling and on sound engineering principles: $1,586,068.92.
Amount not based on solicitor's ruling: $2,130,215.28.
The following points should be noted in connection with this allowance:

(1) The facilities upon which amortization is allowed can be classified as follows: By-product coke plant facilities, coal-mine machinery, machinery for the manufacture of wagons, machinery for the manufacture of tractors, machinery for the manufacture of motor trucks.

(2) The original claim of the taxpayer was only about 40 per cent of the amount finally allowed.

(3) The value-in-use percentage has been figured by the taxpayer and accepted by the bureau's engineer. The figures are not given in the data at hand. It is evident from the date of the report, that 1923 production was not considered.

(4) The specific facilities of the taxpayer have not been examined. A value in use of 58 per cent has been applied to the by-product coke plant and similar percentages to the other plants of the taxpayer. This method is not in accordance with the solicitor's ruling of August, 1923, and must be questioned.

(5) No investigation is made as to the nature of postwar expenditures.

(6) Proper allowance has not been made for the salvage value of items retained in use.

(7) No investigation has been made to determine whether war expenditures were for replacements or for additions.

(8) The value-in-use percentage has been applied to depreciated postwar replacement cost.

IRON AND STEEL

Name: Interstate Iron & Steel Co., Chicago, Ill.
Business: Manufacture of iron and steel goods.
Original amount claimed: $110,977.42.
Final amount claimed: $610,919.93.
Amount finally allowed: $534,878.44.
Date of last determination: May 8, 1923.
Amortization deducted on property discarded or sold: $50,643.11.
Amortization deducted on reduced replacement costs: $181,017.62.
Amortization deducted on value in use: $303,217.71.

Basis of last determination: Estimated postwar value to taxpayer based on ratio of war-time capacity for 5 months in 1918 to average postwar production.

Amount based on solicitor's ruling and on sound engineering principles: $231,660.73.

Amount not based on solicitor's ruling: $303,217.71.

The following points should be noted in connection with this case:

(1) The business of the taxpayer is the manufacture of various forms of steel products.

(2) The original claim of taxpayer was only about 20 per cent of the amount finally allowed.

(3) The value in use percentage has been determined from the ratio of postwar production to war capacity.

(4) The individual facilities of the taxpayer have not been examined as required by solicitor's ruling of August, 1923.

(5) No investigation has been made as to the nature of postwar expenditures.

(6) Proper allowance has not been made for the salvage value of items retained in use.

(7) No investigation has been made to determine whether war expenditures were for replacements or for additions.

(8) The value in use per cent has been applied to depreciated postwar replacement cost.

Name: Jones & Laughlin Steel Co., Buffalo, N. Y.
Business: Steel products.
Original amount claimed: $10,902,580.84.
Final amount claimed: $16,479,478.12.
Amount finally allowed: $7,258,499.17.
Date of last determination: August 7, 1924.
Amortization deducted on property discarded or sold: $1,501,332.84.
Amortization deducted on reduced replacement costs: $4,408.32.
Amortization deducted on value in use: $5,752,758.01.

Basis of last determination: Estimated residual values; difference between depreciated cost and sales price or salvage value; ratio of war-time capacity to average postwar production.

Amount based on solicitor's ruling and on sound engineering principles: $1,505,741.16.

Amount not based on solicitor's ruling: $5,752,758.01.

The following points should be noted in connection with this allowance:

(1) The taxpayer's business is the manufacture of iron and steel products. No question is raised as to the allowances based on discarded values or lowered replacement costs. On the other hand, we do question the allowances made on

reduced value in use, believing that the taxpayer realized no ultimate loss on those facilities retained in use.

(2) The original claim of the taxpayer is about 40 per cent greater than the amount finally allowed.

(3) The value in use percentage is determined from the ratio of average postwar production for 1921, 1922, and 1923 to war capacity.

For example, the percentage in use of blast furnace No. 5, Aliquippa works, is computed as follows:

Maximum war capacity (as shown by actual production in 1920) is 191,586 tons.

Post war production:	Tons
1921	69, 350
1922	90, 493
1923	184, 768
Total	344, 611

Average postwar production equals 114,870 tons.

Average postwar production (114,870 tons) divided by war capacity (191,586 tons) equals the percentage in use, namely, 59.9 per cent.

Amortization is then granted in the amount of 40.1 per cent of cost on this furnace.

It can be readily seen that the 1923 production of this furnace was within 5 per cent of capacity and this is a margin of safety quite small enough in any business. There was no ultimate loss to this taxpayer on account of lowered value in use.

A survey of the following figures will indicate that this taxpayer's business was better in 1923 than it had ever been and that he must have had full use in that year of the facilities retained in use.

Total Bessemer and open-hearth ingot production of taxpayer

	Total tons		Total tons
1916	694, 991	1920	879, 016
1917	797, 855	1921	411, 381
1918	669, 411	1922	792, 754
1919	734, 596	1923	919, 282

The above is sufficient to sustain objections to amortization on lowered value in use of taxpayer's facilities.

(4) While the taxpayer's facilities appear to have been examined to a much greater extent than usual, the value in use percentage has been applied to grouped facilities. This is not in accordance with the solicitor's ruling of August, 1923.

(5) No investigation has been made to determine the nature of postwar expenditures.

(6) Proper allowance has not been made for the salvage value of items retained in use.

(7) No investigation has been made to determine whether war expenditures were for replacements or for additions.

(8) Value-in-use percentage has been applied to war cost less 1917 depreciation.

(9) Amortization has been allowed on subsidiary railroad companies as follows:

Aliquippa & Southern R. R. Co	$156, 241. 38
Monongahela Connecting R. R. Co	126, 710. 50
Total	292, 951. 88

These allowances are illegal, as admitted by the bureau since the Senate committee raised this issue.

General note.—It is interesting in this case to draw a few comparisons between this steel company and the United States Steel Corporation in regard to the treatment they received by the amortization section.

(*a*) The United States Steel Co. is allowed lowered postwar replacement cost and lowered value in use on the same items.

This taxpayer is not allowed both of these deductions on the same items.

(*b*) In January, 1924, the amortization section decided in a formal conference not to recompute amortization on account of the actual figures for 1923 being greater than the estimated figures for this year.

In March, 1924, the amortization section recomputed this taxpayer's case on the basis of actual figures for 1923, the original computation having been made on estimated figures as in the United States Steel case.

SHIPPING

Name: Kerr Navigation Co., New York, N. Y.
Business: Operation of steamships.
Original amount claimed: None stated.
Final amount claimed: $5,498,063.12.
Amount finally allowed: $4,390,115.49.
Date of last determination: September 3, 1920.
Amortization deducted on property discarded or sold: $4,390,115.49.
Basis of last determination: Difference between costs and sale price.
Amount based on solicitor's ruling and on sound engineering principles: $4,390,115.49.
NOTE. This allowance has not been questioned.
It might be noted that the depreciation rate taken on steel ships in this report is 3½ per cent per annum.

IRON AND STEEL

Name: The Koppers Co., Pittsburgh, Pa.
Business: Experimental research, design, construction, and operation of by-product coke ovens, etc.
Original amount claimed: $4,104,338.34.
Final amount claimed: $4,104,338.34.
Amount finally allowed: $2,505,923.16.
Date of last determination: April 25, 1923.
Amortization deducted on property discarded or sold: $251,790.
Amortization deducted on value in use: $2,254,133.16.
Basis of last determination: Estimated salvage value as of December 31, 1918; also salvage values for "value in use."
Amount based on solicitor's ruling and on sound engineering principles: $251,790.
Amount not based on solicitor's ruling: $2,254,133.16.
The following points should be noted in connection with this allowance:
(1) The facilities amortized consist of those necessary for the construction and operation of by-product coke ovens and similar machinery. No exception is taken to the allowance on facilities discarded or sold.
(2) The original claim was about 60 per cent greater than the amount finally allowed.
(3) The value in use percentage is in general determined on the basis of average salvage value. It is contended that although the plants are in regular use, the value in use is less than salvage value, hence salvage value must be used. As before stated we consider this theory erroneous. A coke oven 50 per cent in use is certainly of more value to the taxpayer in his going business than one actually discarded.
(4) The individual facilities of the taxpayer have not been examined as required by the solicitor's ruling of August, 1923.
(5) No investigation has been made to determine the nature of postwar expenditures.
(6) Proper allowance has not been made for the salvage value of items retained in use.
(7) No investigation has been made to determine whether war expenditures were for replacements or for additions.
(8) The value in use percentage has been applied to war cost less 1917 depreciation.

Name: La Belle Iron Works, Wheeling, W. Va.
Business: Manufacture of steel and iron.
Original amount claimed: $600,000.
Final amount claimed: $2,517,143.76.
Amount finally allowed: $1,088,092.52.
Date of last determination: September 21, 1923.
Amortization deducted on property discarded or sold: $77,947.83.
Amortization deducted on value in use: $1,010,144.69.

Basis of last determination: Ratio of average postwar production to war-time capacity.

Amount based on solicitor's ruling and on sound engineering principles: $77,947.83.

Amount not based on solicitor's ruling: $1,010,144.69.

The following points should be noted in connection with this case:

(1) The business of this taxpayer is the manufacture of iron and steel. Allowances based on values of discarded facilities are not questioned.

(2) The original claim of this taxpayer was about 60 per cent of the amount finally allowed.

(3) The value in use percentage is in general the ratio between average postwar production for 1921, 1922, and 1923, to war capacity. The production figures show a very nearly full use of the facilities for the year 1923. Only one list of production figures will be given, as an example:

Steubenville coke plant

	Tonnage of coal carbonized		Tonnage of coal carbonized
1917	456, 623	1921	165, 848
1918	587, 888	1922	380, 670
1919	471, 259	1923	609, 352
1920	502, 690		

Average annual production 1921-1923, 385,290 tons; capacity of plant, 610,000 tons; value in use, 63 per cent.

This plant then is over 99 per cent in use in 1923, yet the engineer allows 37 per cent amortization on lowered value in use. How could the taxpayer produce a tonnage of 609,352 tons in 1923 with a capacity of 385,290 tons? We are obliged to question this allowance and others on a similar basis.

(4) The specific facilities of the taxpayer appears to have been examined, but the amortization is computed by groups or by entire plants. This is not in accordance with the solicitor's ruling.

(5) No investigation has been made to determine the nature of postwar expenditures.

(6) Proper allowance has not been made for the salvage value of items retained in use.

(7) No investigation has been made to determine whether war expenditures were for replacements or for additions.

(8) The value in use percentage has been applied to war cost less 1917 depreciation.

Taxpayer: Lackawanna Steel Co., Buffalo, N. Y.

Business: Recovery of basic natural resources, including iron ore, limestone, calcite, etc.; also production of steel products.

Original amount claimed: $6,202,014.17.

Final amount claimed: $5,207,810.04.

Amount finally allowed: $3,400,579.66.

Date of last determination: January 10, 1924.

Amortization deducted on property discarded or sold: $3,400,579.66.

Basis of last determination: Difference between depreciated cost and sales price.

Amount based on solicitor's ruling and on sound engineering principles: $3,400,579.66.

NOTE.—This allowance, being based on actual sale of property, is not questioned.

MACHINE TOOLS

Name: Le Blond Machine Tools Co., Cincinnati, Ohio.

Business: Manufacture of machine tools.

Original amount claimed: $413,858.45.

Final amount claimed: $678,603.51.

Amount finally allowed: $629,514.75.

Date of last determination: November 15, 1923.

Amortization deducted on property discarded or sold: $47,789.27.

Amortization deducted on reduced repalcement costs: $39,605.54.

Amortization deducted on value in use: $542,119.94.

Basis of last determination: Difference between depreciated cost and sale price or salvage value, also estimated use value in going postwar business.

Amount based on solicitor's ruling and on sound engineering principles: $87,394.81.

Amount not based on solicitor's ruling: $542,119.94.

The following points should be noted in connection with this allowance:

(1) Taxpayer is a manufacturer of machine tools of all kinds. The allowance made on discarded facilities or on the basis of lowered postwar replacement costs is not questioned.

(2) The original claim of taxpayer was about 70 per cent of the amount finally allowed.

(3) The value in use percentage is, in general, based on the estimate of the engineer after studying the production figures, productive man-hours, etc.

(4) The specific facilities of the taxpayer have not been examined. The allowance for amortization therefore on items retained in use is not in accordance with the solicitor's ruling of August, 1923, and must be questioned.

(5) No investigation has been made as to the nature of postwar expenditures.

(6) Proper allowance has not been made for the salvage value of items retained in use.

(7) No investigation has been made to determine whether war expenditures were for replacements or for additions.

(8) The value in use percentage has been applied in some cases to war cost less 1917 depreciation and in some cases to depreciated postwar replacement cost.

AUTOMOBILE MANUFACTURERS

Name: Lincoln Motor Co., Detroit, Mich.

Business: Manufacturers of internal combustion-engines (Liberty motors).

Original amount claimed: $4,819,645.81.

Final amount claimed: $4,819,645.81.

Amount finally allowed: $6,048,915.69.

Date of last determination: December 23, 1921.

Amortization deducted on property discarded or sold: $6,048,915.69.

Amortization deducted on reduced replacement cost: None.

Amortization deducted on value in use: None.

Basis of last determination: Difference between cost and appraised value (appraisal made by appraisers appointed by the United States district court).

Amount based on solicitor's ruling and on sound engineering principles: $4,819,645.81.

Amount not based on solicitor's ruling: None.

Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $1,229,269.88.

The following points should be noted in connection with this case:

(1) The business of this taxpayer was the manufacture of Liberty motors for the United States Government. Its facilities consisted of land, buildings, machinery, and other general equipment used in the manufacture of internal-combustion engines.

(2) The original claim is 25 per cent less than the amount finally allowed.

(3) "Value in use" does not enter into this case, as all facilities were sold. Most of the facilities, however, had been in use and were usable.

(4) The specific facilities were examined by outside parties but not by the bureau in the preparation of the appraisal upon which the final allowance was made.

(5) No investigation was made as to the nature of postwar expenditures.

History.—The Lincoln Motor Co., of Detroit, Mich., was organized in August, 1917, for the purpose of manufacturing Liberty motors for the Government. Under the organization, authorization was for $1,500,000 capital stock of which $850,100 was issued and paid for in cash.

The company acquired a small plant known as the Holden plant in Detroit and commenced the manufacture of Liberty motors. At the instance of the Government and in order to secure increased production a second plant, known as the Warren plant was constructed and erected.

Numerous contracts were entered into between the company and the Government. The first of these was on August 31, 1917, and called for 6,000 Liberty motors to be delivered by June, 1918. This was a cost-plus contract and the estimated cost was $6,087 per motor with a profit of $913.05 per motor. Before any motors had been delivered this contract was modified by reducing the estimated cost to $5,000 per motor and fixing a profit of $625 per motor. Another contract was entered into between the same parties for spare parts on a basis of cost-plus 15 per cent profit. On July 31, 1918, a third contract was executed, which canceled the first two contracts and provided for 9,000 Liberty motors. This last contract was retroactive to the beginning of operations and under it the Government reserved the right to increase the number of motors to 17,000 (which was subsequently done). This contract was for a fixed price of $4,000 per motor with an allowance for amortization.

On January 6, 1919, a contract was executed reducing the number of motors from 17,000 to 6,500. Under the terms of this contract the company was to receive payment at the rate of $4,000 each for 6,500 motors plus an amount equal to 55 per cent of the actual cost of the entire plant, all of which had been acquired subsequent to April 6, 1917, such acquisitions being for the sole purpose of fulfilling war contracts, other payments for special tools, materials on hand, etc., also a sum of $1,000,000 for prospective profits and liquidated damages in full of all claims of the company for or because of the reduction in the number of motors and spare parts.

Finally, or on April 28, 1919, a settlement contract was entered into between the company and the Government whereby the actual amounts to be paid the company in full settlement of all contracts was agreed upon. Up to this time the Government had advanced to the company approximately $10,800,000, the larger part of which had been expended upon plant.

The result of these numerous contracts and adjustments was that the Government paid to the company the following:

6,500 Liberty motors	$26, 000, 000
Amortization	4, 675, 000
Materials, unfinished parts, etc. (approximately)	4, 500, 000
Special tools, etc. (approximately)	1, 600, 000
Liquidated damages	1, 000, 000
Total	37, 775, 000

It should be noted that all of the above items were included in the company's gross income for the purpose of income and excess profit taxes.

In its income tax return for 1918 the Lincoln Motor Co. claimed amortization in the sum of $4,819,645.81. This claim was investigated by Assistant Appraisal Engineer B. L. Wheeler, who in an undated report recommended an allowance of $1,816,627.14. (This report was written on or about January 6, 1920.) The company took exception to a part of this recommendation and as a consequence Engineer Wheeler submitted a revised report, in which he increased the amortization by $34,333.73, making a total allowance of $1,850,960.87. This revised report is dated October 11, 1920. Subsequently, or on October 25, 1920, Engineer S. T. De La Mater, submitted a third report in which he recommended an allowance of $1,944,385.38.

In its original return for 1918 the company reported a net income of $7,368,369.33. In computing the company's net income for 1918 the unit raised the figure to $11,729,845.74, this was largely due to the disallowance of the larger part of the company's claim for amortization. Finally the Income-Tax Unit assessed an additional tax of $4,505,681.23.

Directly after the settlement of its contracts with the Government, the company was faced with the condition of not having any commercial use for its plants, as all of its work had been confined to Liberty motor contracts. Between April and December, 1919, the company endeavored to formulate plans for carrying on a commercial business. A reorganization was effected, new capital secured and the new company launched itself in the business of building motor cars.

In the reorganization the new company issued two classes of stock, class A (preferred) and class B (common of no par value). A part of the class A stock was distributed among certain parties, in accordance with an agreement with the company's bankers and thereafter the company sold to the public the balance of its class A stock in the sum of $5,850,000. It also floated a bond issue amounting to $1,800,000. The different stock sales bond issue and bank loans together with the taking over of all of the physical properties and liabilities including additional tax assessments, of the old company, left the new company in the position where its capital was made up of one-third of property taken over from the old company and two-thirds of new moneys which were put into the new business by banks, stockholders and creditors.

It should be noted that the lands, buildings, machinery, and fixtures of the old company were taken over at a valuation of $3,936,205.84. During March, 1920, an assessment letter was sent to the company advising of an additional tax of $5,725,673.46. A hearing was granted the company and as a result the additional tax was reduced to $5,474,671.18. The case was then referred to special assessment section, which sent out an assessment letter on November 4, 1921, by which the additional tax was reduced to $4,505,681.23; this was arrived at by applying the rate of 70.01 per cent to the company's not income.

Evidently the new company was not successful in its business for on the day following the receipt of the last assessment letter, a receiver in equity was appointed.

The receiver (the Detroit Trust Co.) immediately petitioned the United States district court for permission to appoint appraisers to value the assets of the new company. The court thereupon appointed certain appraisers, who in turn, submitted their appraisals both as of December 31, 1918, and November 7, 1921.

A minimum or liquidating value as of November 7, 1921, is shown as $2,597,752.76. This is made up as follows:

Buildings	$1,120,000.00
Machinery, etc	824,212.76
Land	653,540.00
Total	2,597,752.76

Subsequent to the submission of Mr. De La Mater's report on October 25, 1920, the case was sent to the committee on appeals and review for action. The committee accepts the above appraisal of $2,597,752.76 as the residual value of the property with one exception. They disallow the lowered value of land amounting to a loss of $133,031.66 as shown by appraisal, and thus get a total residual value of $2,730,784.76 on original costs amounting to $8,779,700.45.

On December 23, 1921, this committee handed down its recommendation No. 745 in which it was recommended that the Lincoln Motor Co. be allowed amortization in the sum of $6,048,915.69. In so doing the committee states:

"In fixing the amortization allowance the unit has apparently used its best judgment, but in the light of subsequent events it appears that this valuation so fixed was in error. Subsequent events have proven that the new company has been unable to earn a reasonable return upon the valuation at which the property was accepted from the War Department in part payment of the amount owing to the old company in settlement of its claims. The corporation is now in the hands of a receiver and the balance sheet submitted shows the corporation is barely solvent without the assessment of the additional taxes by the Government. The appraisals show a liquidating valuation of the assets of $2,730,784.42, thereby showing a maximum amortization loss of $6,048,915.69."

Further:

"After considering all the evidence in this case, together with the valuations made by the Income Tax Unit and the valuations submitted by the receiver, and after noting that substantially all of the capital used in the business was borrowed capital, the committee recommends that the action of the Income Tax Unit in fixing the amortization allowance for 1918 at $1,944,385.38 be reversed; that an amortization allowance of $6,048,915.69 be allowed against the net income of the corporation for 1918 and 1919 to be spread upon the basis of the number of motors completed in each year and the net loss sustained in 1919 be allowed against 1918 income in the final adjustment of the taxes for that year; and that upon the basis of a supplemental data sheet prepared at the request of the committee on excess-profits tax of 65.67 per cent of the net income as adjusted in accordance with this recommendation for 1918 be assessed and that the action of the Income Tax Unit in assessing a tax upon the net income as adjusted in the unit at the rate of 70.01 per cent be reversed."

Final recommendation reads as follows:

"Recommended, in the appeal of the Lincoln Motor Co., Detroit, Mich., that the action of the Income Tax Unit in disallowing part of the amortization claimed and adjusting the taxes for 1918 under the provisions of sections 327 and 328 of the revenue act of 1918 at 70.01 per cent, be reversed, and that in lieu of the amount of amortization claimed on the original return there be allowed $6,048,915.69 as a reasonable deduction for the amortization of such part of the cost of the buildings and machinery as has been borne by the taxpayer; and that the net income for 1918 and 1919 be adjusted upon the basis of the foregoing allowance and the tax be fixed upon the net income so adjusted at the rate of 65.67 per cent under the provisions of sections 327 and 328 of the revenue act of 1918 in accordance with the supplemental data sheet prepared by the unit at the request of the committee."

This recommendation was signed by Mr. N. T. Johnson, chairman; "noted" by Mr. Carl A. Mapes, solicitor of internal revenue; "accepted for guidance of the Income Tax Unit" by Mr. D. H. Blair, commissioner.

Investigation of both the engineer's reports and the report and recommendation of the committee discloses that there are five salient points in this case which are worthy of further discussion:

(1) Disallowance of amortization of land.

(2) Basing allowable amortization upon the wrong appraisal figures.

(3) The acceptance of an appraisal by others than the regular appraisers of the unit.

(4) The giving of financial relief to a taxpayer for losses incurred during post-war period due to lack of sound business judgment.

(5) The faulty system in vogue in the unit which permits of reversals of recommendations of the appraisal section without said section being advised thereof.

(1) In recommending allowance for amortization the committee on appeals and review disallowed all claim for amortization of land, stating: "The land cost $780,571.66 and has been appraised at a liquidating value of $653,540, and the decline in value of the land has been eliminated."

It would seem that this disallowance should have set a precedent which would be followed by the appraisal engineers of the unit in subsequent cases, and yet numerous claims have been allowed on land since the date of the committee's report.

This is but one of many instances which substantiates our contention that there is a woeful lack of any set rules or regulations by which all engineers could be guided.

(2) It is noted in the report of the committee that the value at which the facilities, including land, were taken over by the new company was $3,936,205.84. This valuation was placed upon the facilities not long prior to the time of sale to the new company. Moreover, this valuation was agreed on as proper by both a contracting department of the Government (War Department) and the taxpayer. The committee, however, saw fit to disregard this figure and used instead the value as shown in the appraisal made by the appraisers appointed by the court and made as of November 7, 1921, or nearly two years after the sale of the facilities by the old company.

Thus it will be seen that while amortization is allowable only to the old company and while it is freely admitted that the value of these facilities to the old company was $3,936,205.84 and while, according to the appraisals made it was shown that these facilities suffered a reduction in value between the time the new company acquired them and the time the second appraisal was made (a period of 22 months), the committee accepted the lower valuation, or $2,730,784.42, and allowed amortization based upon same. We contend that this action is entirely without merit and is in direct violation of the law governing such cases. It is obvious the losses occurring after January, 1920 (date of sale), could not have anything to do with amortization allowable to an old company which went out of existence at that time.

(3) As stated in another part of this report, the committee on appeals and review used its computations the value of the company's facilities as appraised by "outside" appraisers.

It should be noted that the unit had made a number of appraisals of the old company prior to the action of the committee. Quoting from the committee's report we find, "The unit has made an exhaustive study of the plant and equipment of the old company and has made a number of valuations for the purpose of amortization." Numerous cases have come to the attention of your engineers where appraisals of "outside" appraisers were rejected by the unit and the appraisals made by the unit accepted. As an example we call attention to the case of the Atlantic Refining Co. In this instance the taxpayer had an independent appraisal made which was rejected by the unit and the unit's appraisal used in its stead.

(4) From a careful study of this case it appears that the allowance of $6,048,-915.69 as amortization by the committee on appeals and review served more to relieve the new company from a financial loss due to poor business judgment and management. It should be remembered that the officers and directors of

the new company were identical with those of the old company. Further, that amortization could not be allowed the new company under the law.

The old company was actually engaged in its war-time business for only 21 months, or less than 2 years. The first Liberty motor was not completed until February, 1918.

The old company showed a net income of $7,368,369.33 for 1918. This figure was raised to $11,729,845.74 by the unit. In its report the committee states:

"Apparently a new company was not successful in its reorganization and in its new enterprise and in the meantime had met with financial reverses.

"It had been forced to borrow large sums of money from time to time until the aggregate outstanding liabilities amounted to approximately $8,000,000."

Thus it would seem that the financial distress of the company at the time the first assessment letter was sent was due largely to the operations of the new company and while there may have been means whereby it could have been relieved in some measure, surely, it should not have been done through the medium of an inflated allowance of amortization to the old company. It should be noted that the final claim of the old company for amortization was $4,819,645.69, which is $1,229,270 less than the amount allowed by the committee and it is believed that the old company's claim was not one cent less than the amount to which it considered it was entitled.

It may be interesting to note the following extract from the committee's report and compare the same with the difference between the final amount recommended by the unit's engineer and the amount finally allowed.

"The corporation is now in the hands of a receiver and the balance sheet submitted shows the corporation is barely solvent without the assessment of the additional taxes by the Government."

The final extra assessment was in the sum of $4,505,681.23. The engineer's final allowance was $1,944,385.38. The committee's recommendation was $6,048,915.69, or just $4,104,530.31 more than that of the engineer.

(5) Attention is directed to the fact that the appraisal section has been kept in complete ignorance of the action of the committee on appeals and review.

When your engineers first listed this case it appeared from the unit's records, that the final amount of amortization allowed was $1,944,385.38. This was accepted as being correct. When, however, a detailed study of the case was begun, the report of the committee on appeals and review came to light and it was found that the actual amount of amortization allowed was $6,048,915.69. The unit's records were immediately consulted and it was found that the "last word" both in the unit's engineer's reports and the unit's final tabulated sheets, showing the final amounts as allowed, was an allowance of $1,944,385.38. Your engineer telephoned to Mr. J. T. Keenan, head, appraisal section and explained the situation to him in detail. Mr. Keenan stated that he would investigate the matter at once and advise your engineer. A day or two later another conversation was had with Mr. Keenan, during which, Mr. Keenan stated that in so far as he knew the amount as shown on the tabulated sheets was final, that he was not aware of the fact that the case had gone to the committee on appeals and review, further, that there was no record of the amount as allowed by the unit's engineers having been changed.

We maintain that while it was entirely proper for the committee to pass upon this case it should not have attempted to fix the amount to be allowed as amortization but should have returned the case to the appraisal section with instructions that a redetermination be made on a basis of the principles laid down in their findings. Surely the committee is not an engineering body in any sense of the word and is not in a position to pass judgment on a purely technical subject. It may lay down policies or bases to be followed but the actual computations on engineering questions should be left to the engineers of the appraisal section.

It would appear that the appraisal of this property agreed on between the taxpayer and the War Department shortly prior to its sale to the new company was the best evidence of the value of the plant at time of sale. We question all allowance in excess of this figure.

It should be noted that in addition to the excessive allowance for amortization in this case, the taxpayer also received relief under the special assessment provisions of the revenue act.

SHIPBUILDERS

Taxpayer: Long Beach Shipbuilding Co., Long Beach, Calif.
Business: Shipbuilders.
Original amount claimed: $1,526,958.57.
Final amount claimed: $1,526,958.57.
Amount finally allowed: $1,465,334.87.
Date of last determination: October 3, 1924.
Amortization deducted on property discarded or sold: $1,465,334.87.
Basis of last determination: Difference between depreciated cost and sale price.
Amount based on solicitor's ruling and on sound engineering principles: $1,465,334.87.
NOTE.—This allowance is not questioned.

Name: Los Angeles Ship Building & Dry Dock Co., San Francisco, Calif.
Business: Shipbuilding.
Original amount claimed: $1,203,718.50.
Final amount claimed: $4,646,268.54.
Amount finally allowed: $2,915,922.70.
Date of last determination: May 1, 1923.
Amortization deducted on property discarded or sold: $2,915,922.70.
Basis of last determination: Difference between allowed cost and sales price.
Amount based on solicitor's ruling and on sound engineering principles: $2,604,435.64.
Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $311,487.06.
NOTE.—The allowance is not questioned, being based on sales price, except for an allowance of $311,487.06 made by the Shipping Board and not deducted.

SHIPPING

Taxpayer: Luckenbach Steam Ship Co. (Inc.), New York, N. Y.
Business: Shipping.
Original amount claimed: $613,026.44.
Final amount claimed: $4,194,627.16.
Amount finally allowed: $2,017,060.62.
Date of last determination: April 20, 1923.
Amortization deducted on reduced replacement costs: $2,017,060.62.
Basis of last determination: Difference between war-time expenditures and postwar value of tonnage as prescribed by regulations.
Amount based on solicitor's ruling and on sound engineering principles: $1,518,060.62.
Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $499,000.
NOTE.—Value in use is not a factor in this allowance, but amortization is computed on lowered postwar replacement costs. The following figures should be noted:

Date of contract	Name of vessel	Original contract price
Dec. 4, 1915	F. J. Luckenbach	$877,000
Do	K. I. Luckenbach	877,000
Feb. 9, 1916	Walter A. Luckenbach	945,000
Mar. 10, 1916	Katrina Luckenbach	1,100,000
Total		2,799,000

Final total cost	$5,594,519.16
Less contract price	2,799,000.00
Cost on which amortization should have been based	2,795,519.16
Cost on which amortization was based	3,714,519.16
Costs improperly allowed	919,000.00
Approximate difference in amortization allowance	499,000.00

It is our contention as shown by the above figures that amortization is not allowable on a ship contract entered into before the war started, on the grounds that the facility could not have been acquired for war purposes before there was any war. Amortization could be allowed on costs of $2,795,519.16 for changes and extras after the war period over and above the original contract amount.

IRON AND STEEL

Name: Lukens Steel Co., Catesville, Pa.
Business: Steel products.
Original amount claimed: $1,012,425.35.
Final amount claimed: $3,385,273.37.
Amount finally allowed: $2,418,142.54.
Date of last determination: December 1, 1922.
Amortization deducted on value in use: $2,418,142.54.
Basis of last determination: Ratio of war time capacity to average postwar production. On housing project, ratio of occupancy during war time period and postwar period.
Amount based on solicitor's ruling and on sound engineering principles: None.
Amount not based on solicitor's ruling: $2,418,142.54.
Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: None.
The following points should be noted in connection with this allowance:
(1) The business of the taxpayer is the manufacture of steel plates and other steel products. The whole claim for amortization is based on lowered value in use.
(2) The original claim was only about 45 per cent of the amount finally allowed.
(3) The value in use percentage has, in general, been obtained from the ratio of postwar production for 1919, 1920, and 1921 to war capacity. Inasmuch as this leaves out of consideration the years 1922 and 1923, it is evident that this allowance should have been redetermined by the bureau.
(4) The specific facilities of the taxpayer have not been examined but one value in use applied to the whole plant. This is contrary to the solicitor's ruling of August, 1923.
(5) No investigation has been made as to the nature of postwar expenditures.
(6) Proper allowance has not been made for the salvage value of items retained in use.
(7) No investigation has been made to determine whether war expenditures were for replacements or additions.
(8) The value in use percentage has been applied to war cost less 1917 depreciation.

SHIPBUILDING

Name: McDougall Duluth Co., Duluth, Minn.
Business: Shipbuilding.
Original amount claimed: Not stated.
Final amount claimed: $2,875,920.80.
Amount finally allowed: $2,763,880.44.
Date of last determination: June 27, 1922.
Amortization deducted on property discarded or sold: $2,763,880.44.
Basis of last determination: Difference between depreciated costs and sales price.
Amount based on solicitor's ruling and on sound engineering principles: $2,763,880.44.
NOTE.—This allowance is not questioned, being based on sale price.

IRON AND STEEL

Name: McKeesport Tin Plate Co., McKeesport, Pa.
Business: Manufacture of black and tin plate and other products.
Original amount claimed: $811,121.12.
Final amount claimed: $1,134,865.33.
Amount finally allowed: $691,423.71.
Date of last determination: November 5, 1924.
Amortization deducted on value in use: $691,423.71.
Basis of last determination: Compromise adjustment with taxpayer on value in use factor, applied to boiler plant, also estimated use to taxpayer in going postwar business.

Amount not based on solicitor's ruling: $691,423.71.

The following points should be noted in connection with this case:

(1) The taxpayer is engaged in the manufacture of black and tin plate. The principal facility amortized consists of a new and complete steam plant. The following quotation from the engineer's report should be noted:

"In order to meet the need of war-time requirements for its products the taxpayer was obliged to construct a new steam power plant. Its pre-war plant was old and obsolete and accordingly as new units were installed the old ones were abandoned."

The new plants consist of twelve 606-horsepower boilers complete. It appears in the engineer's report of November 5, 1924, that all of these boilers are used in rotation, and the minimum number necessary for the taxpayer's uses is nine.

(2) The original claim of taxpayer is about 20 per cent greater than the amount finally allowed.

(3) The value in use percentage was obtained by taking the value in use claimed by taxpayer (66⅔ per cent) and averaging this with the value in use found by the bureau's engineer (78⅛ per cent). This resulted in a value in use per cent of 72½ per cent.

The following extract from the supplemental report on amortization dated February 18, 1921, will illustrate this method. (It should be noted that the reexamination of November 5, 1924, simply confirmed this supplemental report without change.)

"An offering in compromise was made to taxpayer by Mr. De La Mater (chief of appraisal section). It was agreed that the value in use of the boiler plant to the taxpayer should be placed at 72½ per cent, or $1,770,248.87, this figure representing the average of the two values claimed as just by the taxpayer and the Government representatives * * *. This offer in compromise, together with conditions imposed upon taxpayer to accept assessment, was agreed to by all present."

The above is another case of fixing the tax by bargaining.

(4) The specific facilities of this taxpayer have been examined.

(5) No examination has been made to determine the nature of the postwar expenditures.

(6) Proper allowance has not been made for the salvage value of items retained in use.

(7) The war expenditures were partly in the nature of replacements and partly in the nature of additions.

(8) Value in use percentage has been applied to war cost.

General note.—We believe the taxpayer will be able to wear out and utilize in his business the full useful life of these 12 boilers and therefore will suffer no ultimate loss except possibly that based on lowered postwar replacement cost.

Now, though this taypayer has certainly received a greater allowance than could be granted on sound economic principles, yet in comparison with the treatment accorded other taxpayers, he has suffered from gross discrimination.

In the Berwind-White case, which the Commissioner of Internal Revenue defends, after the criticism made by the committee on this case in the hearings, advantage was granted taxpayer on three distinct points refused the taxpayer in this case. A comparison of the Bermind-White case and the case of this taxpayer is interesting.

In the first place, the Berwind-White Co. were allowed to average their old worn out and abandoned plant with the new plant to get value in use. This advantage has not been granted this taxpayer. For instance, if the McKeesport Tin Plate Co. had 9 old boilers before the war and put in 12 more new ones during the war, of which they had a postwar need of 9, then, if they had been allowed the method used in the Berwind-White case, their value in use would have been computed as follows: 9 (boilers needed) divided by 21 (total boilers on hand) equals 43 per cent in use. This instead of the 72½ per cent used.

This would more than double the amortization allowance to this taxpayer. Yet the Berwind-White case is exactly parallel to this except that in one case we have a steam power plant and in the other an electric power plant.

In the second place, this taxpayer has been specifically denied the right to amortization on both a lowered value in use basis and a lowered replacement cost basis. Yet in the Berwind-White case both allowances were made on the same items.

In the third place, the Berwind-White Co. were allowed to spread their amortization on the basis of commitments instead of expenditures. The actual expenditures for the Berwind-White Co. were $218,653.27 up to January 1, 1918, yet this company was granted amortization of $333,299.95 in that same year. This right to spread amortization on the basis of commitments granted to the Berwind-White Co. with an advantage of over $100,000 in tax has been specifically denied this taxpayer.

Note the following statement quoted from the bureau engineer's report:

"It was contended that expenditures incurred in connection with the construction of boiler house at the McKeesport plant should be considered as having been established as of the time when the various contracts were entered into instead of when the expenditures were made. This contention was not allowed and the taxpayer was informed that the time of making payments was the time when the expenditures must obtain."

We believe the comparison of the above two cases to be typical of the discrimination suffered by taxpayers in the treatment of amortization and other subjects. In this case a change of policy can not well be argued, for the McKeesport case was set up on February 18, 1921, and reexamined and passed without change on November 5, 1924. The Berwind-White case was settled between these two dates, on November 18, 1922. If, then, the policy in regard to these matters had been liberalized between February 18, 1921, and November 18, 1922, surely the McKeesport Tin Plate Co. should have been granted the benefit of this liberalized policy on November 5, 1924.

Only two conclusions can be drawn from the above.

Either the Berwind-White Co. received about double the proper amount of amortization, or, the McKeesport Tin Plate Co. has been granted only one-half the amortization allowance rightfully their due.

The commissioner has stated his approval of the Berwind-White case.

Our own opinion is that in both of these cases, amortization should have been confined to the difference between war cost and depreciated postwar replacement cost.

IRON AND STEEL

Name: McKinney Steel Co., Cleveland, Ohio.
Business: Iron and steel.
Original amount claimed: $1,102,858.78.
Final amount claimed: $1,200,286.08.
Amount finally allowed: $1,185,859.15.
Date of last determination: December 1, 1921.
Amortization deducted on property discarded or sold: $14,427.93.
Amortization deducted on value in use: $1,171,431.22.
Amount based on solicitor's ruling and on sound engineering principles: $14,427.93.
Amount not based on solicitor's ruling: $1,171,431.22.

NOTE.—This plant was shut down at date of engineer's inspection in August, 1921, having been shut down since the first of the year.

The allowance is practically as claimed by taxpayer. The engineer does not even visit the separate plants.

This claim should have been redetermined by the commissioner on or about March 3, 1924, as provided for in the statutes, whether the taxpayer requested this action or not. On the very meager data at hand we are obliged to question the greater part of this allowance.

SHIPBUILDING

Name: Manitowoc Shipbuilding Co., Manitowoc, Wis.
Business: Shipbuilders.
Original amount claimed: $1,289,896.74.
Final amount claimed: $1,023,695.99.
Amount finally allowed: $1,014,558.99.
Date of last determination: November 1, 1924.
Amortization deducted on property discarded or sold: $1,014,558.99.
Basis of last determination: Difference between depreciated cost and sales price.
Amount based on solicitor's ruling and on sound engineering principles: $1,014,558.99.

NOTE.—This allowance is not questioned, being based on sale price.

MISCELLANEOUS

Name: Matthiesen & Hegeler, La Salle, Ill.
Business: Production of spelter, sheet zinc, and sulphuric acid.
Original amount claimed: $287,081.48.
Final amount claimed: $969,159.73.
Amount finally allowed: $832,355.37.
Date of last determination: February 3, 1923.
Amortization deducted on property discarded or sold: $687,682.16.
Amortization deducted on reduced replacement costs: $47,823.61.
Amortization deducted on value in use: $96,849.60.
Basis of last determination: Difference between depreciated cost and estimated salvage value, also ratio between war-time use and postwar use.
Amount based on solicitor's ruling and on sound engineering principles: $735,505.77.
Amount not based on solicitor's ruling: $96,849.60.
NOTE.—The greater portion of this claim is not questioned, being allowed on property discarded or sold. Exception is taken to lowered value in use on retained items on the usual grounds.

SHIPBUILDING

Name: Merchants Ship Building Co., Chester, Pa.
Business: Shipbuilding.
Original amount claimed: None stated.
Final amount claimed: $4,493,535.49.
Amount finally allowed: $1,422,770.58.
Date of last determination: September 22, 1924.
Amortization deducted on property discarded or sold: $1,422,770.58.
Basis of last determination: Difference between depreciated cost and sales price or salvage values.
Amount based on solicitor's ruling and on sound engineering principles: $1,422,770.52.
NOTE.—This allowance has not been questioned, as it is based on sale or salvage value.

MACHINERY MANUFACTURING

Name: Mesta Machine Co., Pittsburgh, Pa.
Business: Heavy machinery.
Original amount claimed: None stated.
Final amount claimed: $1,296,930.30.
Amount finally allowed: $854,845.86.
Date of last determination: March 23, 1921.
Amortization deducted on property discarded or sold: $230,539.
Amortization deducted on value in use: $624,306.86.
Basis of last determination: Difference between depreciated cost and sales Price or salvage values. Use value of taxpayer in normal postwar business.
Amount based on solicitor's ruling and on sound engineering principles: $230,539.
Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $624,306.86.
The following points should be noted in connection with this allowance:
(1) The taxpayer's business is the manufacture of heavy machinery, such as gas and steam blowing engines, rolling-mill machinery, forging presses, shears, etc. No exception is taken to the allowance of amortization on property discarded or sold.
(2) The amount of the original claim is not stated.
(3) The value in use percentage is based on a direct estimate of the engineer, consideration being given to floor space, productivity, etc., of buildings and groups of facilities.
(4) The individual facilities of the taxpayer appear to have been examined.
(5) No investigation has been made to determine the nature of postwar expenditures.
(6) The salvage value of items retained in use has not been allowed for.
(7) No investigation has been made to determine whether war expenditures were for replacements or for additions.

(8) Value-in-use percentage has been applied to war cost.

GENERAL NOTE.—No record is obtainable as to 1922 and 1923 production. This claim must be questioned as items retained in use were examined at a time of excessive business depression.

IRON AND STEEL

Name: Midvale Steel & Ordnance Co., New York, N. Y.
Business: Manufacture of steel and steel products.
Original amount claimed: $5,018,661.
Final amount claimed: $10,289,558.18.
Amount finally allowed: $9,330,440.16.
Date of last determination: February 18, 1921.
Amortization deducted on property discarded or sold: $9,330,440.16.
Amount based on solicitor's ruling and on sound engineering principles: $9,330,440.16.

NOTE.—This allowance is not questioned, being based on actual sales price.

MACHINERY MANUFACTURING

Name: Moline Plow Co., Moline, Ill.
Business: Wagons, tractors, and harvesting machinery.
Original amount claimed: $157,466.42
Final amount claimed: $934,905.42.
Amount finally allowed: $928,816.58.
Date of last determination: May 1, 1922.
Amortization deducted on reduced replacement costs: $493,336.01.
Amortization deducted on value in use: $378,676.26.
Basis of last determination: Difference between depreciated cost and sale price or salvage values, also estimated value in use factor as applied to estimated postwar replacement cost.
Amount based on solicitor's ruling and on sound engineering principles: $550,140.32.
Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $378,676.26.

NOTE.—The allowances made on the basis of lowered postwar replacement cost and on discarded facilities are not questioned. It is believed that there has been no ultimate loss on items retained in use.

Attention is called to the fact that amortization has been allowed on certain items on both a lowered replacement cost and a lowered value in use basis. This procedure has been specifically denied in many cases.

SHIPPING

Name: Munson Steamship Lines, New York, N. Y.
Business: Shipping.
Original amount claimed: $546,965.90.
Final amount claimed: $1,072,130.84.
Amount finally allowed: $927,668.08.
Date of last determination: July 20, 1923.
Amortization deducted on reduced replacement costs: $927,668.08.
Basis of last determination: Difference between depreciated cost and computed residual values based upon difference in price of dead-weight tonnage.
Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $927,668.08.

NOTE.—The entire allowance in this case is based on vessels contracted for before the war period, as follows:

Name of vessel	Date of contract	Amortization allowed
W. D. Munson	Aug. 4, 1916	$369,333.07
Munindies	Dec. 6, 1915	213,968.19
Munaires	Apr. 20, 1916	344,366.82
Total		927,668.08

The amortization allowed as shown above, amounts to approximately 41 per cent of the total costs of the vessels. Amortization is based on lowered postwar replacement cost, as the vessels are in use.

As before stated, we contend that commitments, such as these, entered into long before the war, constitute prima facie evidence that the vessels were not acquired for war purposes.

Amortization in these cases should be denied except on costs of changes and extras made during the war period.

DYES

Name: National Aniline & Chemical Co. (Inc.), New York, N. Y.
Business: Manufacture of coal-tar dyes, intermediate and other chemicals.
Original amount claimed: $550,667.37.
Final amount claimed: $10,788,867.06.
Amount finally allowed: $9,912,740.08.
Date of last determination: Engineer's report not dated.
Amortization deducted on property discarded or sold: $8,258,989.43.
Amortization deducted on reduced replacement costs: $1,653,750.65.
Basis of last determination: Reduced postwar replacement costs.

Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $9,912,740.08.

The following general points should be noted in connection with this allowance:

1. The facilities amortized in this case consist of items necessary in the manufacture of coal-tar dyes and other chemicals, such as tanks, pumps, towers, furnaces, condensers, fans, motors, scales, vats, transmission, concentrators, coolers, buildings, machine tools, furniture, etc.

2. The original amount claimed was about 10 per cent in excess of the amount finally allowed.

3. Amortization is not based on reduced value in use but on one of the following grounds:

(a) Difference between cost and sale price.
(b) Difference between cost and salvage value.
(c) Difference between cost and salvage value when abandoned in the future.
(d) Difference between cost and depreciated postwar replacement cost.

This amortization allowance also contains certain important features which will be briefly discussed.

In the first place the issue is specifically raised in this case on the question of what industries contribute to the prosecution of the war. It is obvious that in making any amortization allowance the first point was to determine whether or not any amortization should be granted, as under the statute the taxpayers must have acquired facilities for the production of articles contributing to the prosecution of the war in order to be entitled to any allowance.

In this case the amortization claim of the taxpayer was originally disallowed on the grounds that dyeing or the production of dyes was not an industry necessary for the prosecution of the war. Subsequently this idea of the amortization section seems to have changed and the taxpayer was allowed nearly $10,000,000 in amortization. This appears to have been done without any ruling by the solicitor or any other authority outside the engineering division.

We believe a broad interpretation of the statute will permit of the amortization allowance in the case, but the point was close enough to require a ruling by the solicitor. Further, there exist cases in amortization which have been disallowed on the grounds that dyeing is not an industry necessary for the prosecution of the war.

When a company is disallowed amortization on the grounds it is in the dye business, how can they know that another dye company can come in subsequently and get amortization, when absolutely nothing is published on the subject? This is a frightful inequity, but it exists in this case.

Our engineer, Mr. Thomas, has made a brief investigation of this subject in respect to the 10 cases listed below.

Taxpayer	Business	Amount claimed	Amount allowed
Sumerdale Dyeing, Printing & Finishing Works.	Dyeing, finishing, and printing cotton cloth.	$62,135.30	$29,580.19
Swiss Cleaners and Dyers	Dyeing and cleaning	13,934.66	
Manhattan Sponging Works	Sponging cloth	4,893.53	4,893.53
B. S. Morse & Co. (Inc.)	Cloth examined and shrunk	1,324.32	
Brooklyn Finishing Co.	Dyeing cloth	11,500.00	
Mount Hope Finishing Co.	do	49,304.95	49,304.95
Mutual Examining & Refinishing Co.	Sponging and examining cloth	3,096.82	
Lowell Bleachery	Dyeing and bleaching	20,924.49	20,924.49
Fiskdale Finishing Co.	do	5,596.50	7,719.84
Edgewater Dyeing & Finishing Co.	Dyeing and finishing	10,393.00	

Mr. Thomas states that:

"A review of the above 10 cases tends to substantiate the contention that the question of allowing amortization to this class of taxpayers has been handled in a most unsound manner. These 10 cases were selected at random, and there is nothing to indicate that the same unsound basis upon which amortization was determined has not been adhered to in all other cases of a similar character.

"Earlier in this report the writer stated that the question as to whether or not amortization was properly allowable was answered in accordance with the personal views of the individual engineer handling the case. He might go a step further and say that it was answered in accordance with the personal view of that individual engineer at a particular time. To illustrate this fact, attention is called to several of the engineer's reports touching on this subject.

"In the case of the Brooklyn Finishing Co. (Inc.), Engineer Griffith stated in his report that, 'Inasmuch as the process of dyeing is a service rather than a manufacturing operation, the unit has ruled that facilities purchased to execute contracts to dye cloth are not subject to amortization. Therefore amortization amounting to $11,500 as claimed by the taxpayer is disallowed in full.' He, however, allows this amount ($11,500) under the caption of 'Loss of useful value.'

"In the case of the Lowell Bleachery, Mr. William F. R. Griffith, engineer, states that the taxpayer was engaged in dyeing, waterproofing, and paraffining duck material. In his report there appears the following:

"'Inasmuch as most of the duck that was dyed was either paraffined or waterproofed as well there seems to be no question but that the facilities on which amortization is claimed are subject to amortization.'

"As a result, the full amount claimed, or $20,924.49, was allowed as amortization.

"It should be noted that this is the same Mr. Griffith who disallowed the claim for amortization in the case of the Brooklyn Finishing Co. In making this disallowance Mr. Griffith states:

"'Inasmuch as the process of dyeing is a service rather than a manufacturing operation, the unit has ruled that facilities purchased to execute contracts to dye cloth are not subject to amortization. Therefore amortization amounting to $11,500 as claimed by the taxpayer is disallowed in full.'

"Referring to this last quotation it may be said that the writer has not been able to find any ruling of the unit covering this point.

"In the case of the Edgewater Dyeing & Finishing Co., Mr. H. F. Coombs, engineer, states that taxpayer's business was dyeing, finishing, printing, and napping of cotton piece goods, and that the 'articles produced in this company's plant that contributed to the prosecution of the war were finished fabrics for gas masks, dyeing duck for the Ordnance Department, dyeing and finishing canvas for the Marine Corps.' Thus it will be seent hat it was practically admitted that taxpayer's facilities were amortizable. However, its claim was disallowed on the basis of 'replacement costs' and not because the facilities involved were not properly amortizable. It should be noted that this case is still pending in the unit.

"In the case of the Fisk lale Finishing Co., Mr. J. M. Clack, engineer, allows the entire amount of amortization claimed, namely $2,123.25. In the discussion of this claim, Mr. Clack does not touch upon the question as to whether or not the facilities involved are subject to amortization, although this taxpayer's business was bleaching and dyeing.

"In the case of the Manhattan Sponging Works, Engineer E. A. Hind allows $4,893.53, the full amount claimed for amortization. This taxpayer engaged in the business of sponging and finishing cloth.

"In the case of Benj. S. Moss & Co. (Inc.), Engineer S. P. Hall and J. P Moore, in their report state that the taxpayer engaged in the business of shrinking and examining cloth used in Government uniforms. The claim for amortization was for $1,324.42. The whole amount was disallowed for the reason that:

"'It is considered by the amortization section that dyestuffs and other products similar to those manufactured by the taxpayer can not be classed as articles essential for the successful prosecution of the war, and facilities acquired for the production of same are therefore not properly subject to amortization, and in view of this policy the amortization claimed is not recommended for allowance.'

"In the case of the Mount Hope Finishing Co., Engineer L. L. Thwing submitted a report in which he recommends an allowance of $49,304.95, the full amount claimed, for amortization. This taxpayer was engaged in the business of dyeing and finishing certain material used for war purposes.

"The Mutual Examining & Refinishing Co. of New York submitted a claim for amortization in the sum of $3,096.82. In his report, Engineer Lenox recommended a total disallowance of the claim and stated:

"'An amortization allowance is applicable only to such cases where the business of the taxpayer was the actual production of articles contributing to the prosecution of the war.' The business of the taxpayer, 'cloth examining and sponging,' is of course not the production of an article and the taxpayer is, therefore, not entitled to an amortization deduction for tax purposes.

"In the case of the Swiss Cleaners and Dyers, of Louisville, Ky., taxpayer claimed amortization in the sum of $13,934.66. Taxpayer's business was that of cleaning clothes, bedding, etc., for the Government. Engineer disallowed this claim in its entirety.

"It is interesting to compare the actions of the several engineers who either compiled the engineer's report or reviewed or approved same. In so doing, it must be remembered that all of the 10 taxpayers, whose claims are under discussion, were either in the same or similar line of business, and that if amortization was properly allowable in one case it was properly allowable in all cases. The record of these 10 cases discloses the fact that Mr. De La Mater, as chief of section, approved the appraisal engineers' recommendations on seven claims, three of which were allowances and four disallowances.

"Mr. Griffith, as appraisal engineer recommended 'allowance' in one claim and 'disallowance' in one.

"Mr. Thwing, as appraisal engineer, submitted a report on one claim wherein he recommended 'allowance' and as reviewing engineer approved one 'allowance' and one 'disallowance'."

We consider that the disallowance of amortization to the Swiss Cleaners and Dyers, the B. S. Morse & Co. (Inc.), the Brooklyn Finishing Co., the Mutual Examining & Refinishing Co., and the Edgewater Dyeing & Finishing Co., is a gross discrimination against these taxpayers in view of the fact that other taxpayers in the same line of business received this allowance. The companies mentioned above had absolutely no way of knowing the change of the attitude on this point by the appraisal section. Nothing was published by the bureau on the subject, and the system of secrecy employed in each individual case makes it impossible for the taxpayer to know of his rights in any way. We consider the inequity in these cases a very good argument for publicity.

In the second place we contend that this taxpayer was not entitled to amortization in any form on the appraised value of items included in the seven old plants merged into one, by him during the war period. Costs of items of this character form about 90 per cent of the claim.

The history of this company shows that it was incorporated in May, 1917, and in 1917 purchased for its stock seven operating dye and chemical plants located as follows: Buffalo, N. Y.; Wappingers Falls, N. Y.; Brooklyn, N. Y.; Marcus Hook, Pa.; Easton, Pa.; Shady Side, N. J.; Newburgh, N. Y.

"The price paid to the vendor companies was arrived at through a committee of engineers, composed of members from each plant, and an actual unit quantity appraisal was used, priced to represent the conditions as of the time of purchase. Depreciation was allowed for and the price paid represents the depreciated value."

It would appear from an indefinite statement in the record, that this price paid was $18,669,800. This would leave costs of $1,451,873.57 which might be properly amortized, being for increasing production during the war period.

It is our contention that there was absolutely no intent on the part of Congress when it passed the revenue act to provide an allowable deduction for amortization to a company which merged several operating plants in one, when such merger did not increase by one pound the capacity of the facilities producing articles contributing to the war.

Suppose, for instance, that the United States Steel Corporation had a depreciated cost of physical assets on their book as of November, 1917, of $2,000,000,000. Suppose now a new corporation is formed and buys out the Steel Corporation at an appraised value. Since the value of the dollar is now only 50 cents against par for 1913, the appraised value may be predicted as $4,000,000,000. Now, after the war, although the facilities are in full use, in this case the successor to the Steel Corporation might be allowed amortization of about 15 per cent on $4,000,000,000 worth of appraisal value, or a sum of $600,000,000. In other words under this system all a corporation had to do was to reorganize in order to get amortization on facilities they had owned and operated for years in their peace-time business.

If our contention is correct in this matter, it is obvious that an erroneous amortization allowance of at least $8,000,000 has been made in the case of the National Aniline & Chemical Co.

In the third place, this taxpayer is allowed to take the difference between appraisal value (reduced by 1917 depreciation) and the sale or salvage value as the amount of amortization. It appears that after the war in the interests of economy, taxpayer decided to concentrate all his facilities at Buffalo. He proceeded therefore to scrap six of his plants. He did not offer these plants for sale as going business concerns, as he had bought them, but simply dismantled the plants. Of course, it is obvious he did not wish to sell the plants as a whole as he did not wish to put competitors in the market against him, regardless of the fact that he could have received a much greater price from the sale of the plants as a going business. The centralization of the business at Buffalo caused large expenditures at this point which were for facilities of a nature similar to those on which amortization was granted.

Conclusion.—We condemn the basic principles on which amortization rests in this case, as being far beyond any intent of Congress in passing this relief provision.

We also call attention to the necessity for published rulings in the matter of determining what industries are entitled to amortization.

MINING

Name: Newport Mining Co. and subsidiaries, Milwaukee, Wis.
Business: Mining of iron ore.
Original amount claimed: $1,211,000.69.
Final amount claimed: $3,152,013.41.
Amount finally allowed: $1,185,270.33.
Date of last determination: November 5, 1923.
Amortization deducted on property discarded or sold, $521,517.69.
Amortization deducted on value in use: $663,752.64.
Basis of last determination: Houses; ratio of war time and postwar time occupancy; also ratio of war-time capacity to average postwar production.
Amount based on solicitor's ruling and on sound engineering principles: $521,517.69.
Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $663,752.64.

The following points should be noted in connection with this allowance:

(1) The business of this taxpayer consists of iron mining, coal mining, coke and gas manufacture, and production of chemicals. The amortization allowance based on property discarded or sold is not questioned.

(2) The original claim of this taxpayer was about 5 per cent greater than the amount finally allowed.

(3) The value in use percentage is, in general, the ratio of average production for 1921, 1922, and four months of 1923, to war capacity. In view of the nearly full use in 1923 of the taxpayer's facilities which were retained, it is believed that amortization deducted on this theory of average 1921, 1922, and 1923 production should be questioned.

(4) The specific facilities of taxpayer have not been examined.

(5) No investigation has been made to determine the nature of postwar expenditures.

(6) Proper allowance has not been made for the salvage value of items retained in use.

(7) No investigation has been made to determine whether war expenditures were for replacements or for additions.

(8) Value in use percentage has been applied to war cost less 1917 depreciation.

MACHINE TOOLS

Name: Niles, Bement, Pond Co., New York, N. Y.
Business: Machine tools and allied products.
Original amount claimed: Not stated.
Final amount claimed: $1,388,833.84.
Amount finally allowed: $1,113,465.38.
Date of last determination: August 19, 1922.
Amortization deducted on value in use: $1,113,465.38.
Basis of last determination: Difference between cost and estimated residual value.
Amount not based on solicitor's ruling: $232,421.
Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $881,044.38.
The following points should be noted in connection with this allowance:
(1) The taxpayer is a manufacturer of small tools. The allowance is based entirely on value in use, no discarded facilities being listed.
(2) The amount of the original claim is not stated.
(3) The value in use percentage is a direct estimate of the engineer, based principally on salvage value.
(4) The individual facilities have not been examined for a specific determination of amortization, and the allowance must be questioned.
(5) No investigation has been made as to the nature of postwar expenditures.
(6) Proper allowance is not made for the salvage value of items retained in use.
(7) No investigation has been made to determine whether war expenditures were for replacements or for additions.
(8) Value in use per cent has been applied to war cost less 1917 depreciation.
(9) Amortization amounting to $232,421 has been granted on land.
GENERAL NOTE.—No production figures and no data as to discarded facilities are given in the engineer's report. It is probable that this taxpayer is entitled to amortization on the sound economic basis of value of discarded facilities if same were properly listed.

SHIPBUILDING

Name: Northwest Steel Co., Portland, Oreg.
Business: Shipbuilding.
Original amount claimed: $815,762.46.
Final amount claimed: $815,762.46.
Amount finally allowed: $615,762.46.
Date of last determination: July 11, 1921.
Amortization deducted on property discarded or sold: $615,762.46.
Basis of last determination: Difference between cost and sale price.
Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $615,762.46.
NOTE.—This case was reported on in the hearings before the Senate committee and it is not necessary to discuss same again.

MUNITIONS

Name: Ohmer Fare Register Co., Dayton, Ohio.
Business: Gun mounts, sights, and tools for manufacturing war facilities.
Original amount claimed: $831,747.90.
Final amount claimed: $597,942.68.
Amount finally allowed: $539,313.83.
Date of last determination: June 22, 1923.
Amortization deducted on property discarded or sold: $530,708.90.
Amortization deducted on reduced replacement costs: None.
Amortization deducted on value in use: $8,604.93.
Basis of last determination: Ratio of estimated use value during postwar period to depreciated costs, also residual values based upon price which taxpayer would sell facilities, also difference between depreciated cost and sales price or salvage value.
Amount based on solicitor's ruling and on sound engineering principles: $530,708.90.
Amount not based on solicitor's ruling: None.

Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $8,604.93.

NOTE.—While the business of this taxpayer is normally the manufacture of fare registers, inasmuch as only the special war industry of manufacturing gun mounts and sights is under consideration for amortization, and because practically the whole claim is based on sale or salvage value, we do not question this allowance.

SHIPPING

Name: Ore Steamship Corporation, New York, N. Y.
Business: Transportation of ore and manganese ore for Bethlehem Steel Co.
Original amount claimed: Not stated.
Final amount claimed: $1,534,952.74.
Amount finally allowed: $1,466,389.53.
Date of last determination: November 21, 1923.
Amortization deducted on value in use: $1,466,389.53.
Basis of last determination: Difference between depreciated cost and residual value.
Amount based on solicitor's ruling and on sound engineering principles: $1,466,389.53.
NOTE.—This allowance is based on a promulgated ruling allowing a residual value of $56 per dead-weight ton, and is not questioned.

Name: Oriental Navigation Co., New York, N. Y.
Business: Operating, buying, and selling ships.
Original amount claimed: $349,286.25.
Final amount claimed: $827,443.77.
Amount finally allowed: $710,883.
Date of last determination: November 8, 1924.
Amortization deducted on property discarded or sold: $710,883.
Basis of last determination: Difference between actual costs and sales price plus depreciation.
Amount based on solicitor's ruling and on sound engineering principles: $710,883.
NOTE.—This allowance is not questioned as it is based on sales price.

Name: Pacific Steamship Co., Seattle, Wash.
Business: Shipping.
Original amount claimed: $440,000.
Final amount claimed: $1,423,917.12.
Amount finally allowed: $645,264.07.
Date of last determination: November 15, 1924.
Amortization deducted on value in use: $645,264.07.
Basis of last determination: Difference between cost and insurance received plus arbitrary amount of 5 per cent on cost, also difference between cost and sales price plus arbitrary 10 per cent of cost.
Amount based on solicitor's ruling and on sound engineering principles: $645,264.07.
NOTE.—The above allowance is not questioned.

Name: Pan-American Petroleum & Transportation Co., New York, N. Y.
Business: Transportation of oil.
Original amount claimed: $5,663,360.21.
Final amount claimed: $5,663,360.21.
Amount finally allowed: $1,892,624.98.
Date of last determination: November 4, 1924.
Amortization deducted on reduced replacement costs: $1,892,624.98.
Basis of last determination: Postwar replacement cost as figured from bureau's ratios.
Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $1,892,624.98.

All facilities were contracted for in 1915 and 1916, showing that they were not constructed for war purposes, and, therefore, they are not subject to amortization.

A list of the vessels with dates of contracts follow:

Name of ship	Date of contract	Name of ship	Date of contract
G. W. Barnes	Mar. 18, 1916	G. G. Henry	Mar. 28, 1916
E. L. Doheny, Jr.	May 6, 1915	F. H. Kellogg	Mar. 30, 1916
E. L. Doheny, III	Jan. 15, 1916	S. M. Spaulding	Apr. 28, 1916
William Green	Nov. 17, 1915	W. L. Steed	Mar. 18, 1916
P. H. Harwood	Apr. 28, 1916	H. Walker	Nov. 17, 1915

Amortization on the above vessels amounts to $1,892,624.98. As before stated, we believe that this allowance was not contemplated by the statute and is illegal, for these vessels could not be considered to have been purchased or constructed for war purposes.

We believe amortization on these ships should be confined to costs of changes and extras contracted for during the war period.

OIL

Name: Pierce Oil Corporation, New York, N. Y.

Business: Transportation of crude oil from wells to refineries and refinement of same.

Original amount claimed: $2,000,000.

Final amount claimed: $3,922,719.19.

Amount finally allowed: $1,393,368.21.

Date of last determination: August 30, 1924.

Amortization deducted on property discarded or sold: $848,625.83.

Amortization deducted on reduced replacement costs: $482,2[illegible]5.51.

Amortization deducted on value in use: $62,466.87.

Basis of last determination: Difference between depreciated cost and sale or salvage value, difference between war time cost and post-war replacement cost, and ratio of war-time activity of plant to post war activity of plant.

Amount based on solicitor's ruling and on sound engineering principles: $44,453.86.

Amount not based on solicitor's ruling: $1,348,914.35.

The following point should be noted in connection with this allowance:

The engineer's report states that "the taxpayer's business prior to, during, and subsequent to the war was confined to the transportation of crude oils from the well to its refineries and refining the crude oil into its various finished products * * *" We are obliged to question this claim largely on the amortization allowed on strictly transportation facilities. Inasmuch as railroads are excluded from the benefits of amortization, it appears evident that amortization on the general transportation facilities (except vessels) of any taxpayer should be disallowed.

A list of such transportation facilities with amortization allowed follows:

	Amortization allowed
Tank cars	$437, 820. 65
Healdton pipe line	829, 082. 01
Ranger pipe line	3, 486. 84
Total	1, 270, 389. 50

As the above allowances comprise nearly all the amount questioned and appear to be illegal, this case will not be discussed further.

MINING

Name: Pocahontas Fuel Co., New York, N. Y.

Business: Coal mining.

Original amount claimed: $1,270,248.86.

Final amount claimed: $1,539,763.33.

Amount finally allowed: $854,218.02.

Date of last determination: February 26, 1924.

Amortization deducted on reduced replacement costs: $246,922.70.

Amortization deducted on value in use: $607,295.32.

Basis of last determination: Ratio of capacity during part of war period, and average postwar production, men employed, occupancy of houses, also costs less residual value.

Amount not based on solicitor's ruling: $607,295.32

Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $246,922.70.

The following points should be noted in connection with this allowance:

(1) The taxpayer is in the coal mining business, the principal facilities on which amortization is allowed consisting of a large number of tenant houses, mine equipment, and a steamship.

(2) The original claim of the taxpayer was about 50 per cent in excess of the amount finally allowed.

(3) The value-in-use percentage of mine equipment is based on the ratio of postwar production for 1921, 1922, and 1923 to war capacity. A value in use on this basis of 60 per cent is found. In this connection note the following statement in the engineer's report when referring to the estimated war capacity:

"* * * this estimated capacity has never been reached, except during one quarter in 1923 * * *."

This shows that for one quarter in 1923 all previous production records of the taxpayer were broken and full use of the war facilities were required.

In regard to the tenant houses, the value in use is based on occupancy of rooms. The total number of rooms is 1,301, the occupancy follows:

	1921	1922	1923		1921	1922	1923
First quarter	694	254	895	Third quarter	208	725	1,063
Second quarter	59	460	966	Fourth quarter	374	780	1,019

This shows again that the 1923 occupancy was 80 per cent of the maximum. still the value in use is fixed at 52 per cent.

(4) Amortization has not been determined on each specific facility as required by the solicitor's ruling of August, 1923.

(5) No investigation has been made as to the nature of postwar expenditures.

(6) Proper allowance has not been made for the salvage value of items retained in use.

(7) No investigation has been made to determine whether war expenditures were for replacements or for additions.

(8) The value-in-use percentage has been applied to war cost less 1917 depreciation.

Amortization has been allowed on the steamship *Freeman* amounting to $246,922.70. We believe this allowance improper because the vessel was contracted for on November 19, 1915, or one year and five months before the declaration of war. Amortization should be confined to the cost of changes and extras for war purposes.

SOAP

Name: Procter & Gamble Co., Cincinnati, Ohio.

Business: Manufacture of soap and by-products.

Original amount claimed: None stated.

Final amount claimed: $5,332,254.49.

Amount finally allowed: $3,997,848.67.

Date of last determination: January 19, 1923.

Amortization deducted on property discarded or sold: $666,912.

Amortization deducted on reduced replacement costs: $1,017,433.

Amortization deducted on value in use: $2,313,503.67.

Basis of last determination: Ratio of war-time capacity and production to estimated average postwar monthly production, also difference between depreciated costs and sales price; also estimated residual value.

Amount based on solicitor's ruling and on sound engineering principles: $666,912.

Amount not based on solicitor's ruling: $3,330,936.67.

The following points should be noted in connection with this allowance:

(1) The business of the taxpayer is the manufacture of soap and various by-products. No exception is taken to allowances made on the basis of lowered postwar replacement costs nor to allowances made on the basis of facilities discarded or sold. It is considered that there has been no ultimate loss to this taxpayer on facilities retained in use. It should also be pointed out that there is considerable doubt as to whether a soap manufacturer is entitled to any

amortization on the grounds that the article produced did not contribute to the prosecution of the war.

(2) The amount of the original claim by this taxpayer is not stated in the papers at hand.

(3) The value-in-use percentage is, in general, determined from the ratio of average production in 1921–22 to war capacity. As an example of this method, note the following quotation from the engineer's report:

"*Soap department.*—This plant has 60 soap kettles, with a monthly capacity of 21,000,000 pounds. Production for 1921–22 averaged 12,266,000 pounds, and residual value of 65 per cent is applied to all facilities in use in this department."

(4) The specific facilities of taxpayer have not been examined as required by solicitor's ruling of August, 1923.

(5) No investigation has been made as to the nature of postwar expenditures.

(6) Proper allowance has not been made for salvage value of items retained in use.

(7) No investigation has been made to determine whether war expenditures were for replacements or for additions.

(8) In some cases the value-in-use percentage has been applied to war cost less 1917 depreciation, and in some cases to lowered postwar replacement cost.

(9) Amortization of over $1,000,000 has been allowed on tank cars.

This case is illustrative of the first point which should be determined in any amortization case. The question to be first answered is, Did the facilities acquired by the taxpayer contribute to the prosecution of the war?

We admit of the difficulty in drawing the line of demarcation between facilities which did contribute and which did not contribute to the war. We do criticize the bureau, however, for not ruling on this question, so that the engineers could be properly guided. This is mainly a legal and not an engineering matter.

We submit that if soap is an article necessary to the prosecution of the war, then almost every manufacturer in the country should have been allowed amortization.

In a case passed by the appraisal section about one year after this Procter & Gamble case, it is stated that soap is not considered as an article necessary for the prosecution of the war. This shows the absolute lack of rules governing the first basic fact which should be considered in every amortization case.

OIL

Name: Pure Oil Co., Columbus, Ohio.

Business: Oil.

Original amount claimed: $809,792.50.

Final amount claimed: $809,792.50.

Amount finally allowed: $788,559.59.

Date of last determination: June 30, 1924.

Amortization deducted on reduced replacement costs: $788,559.59.

Basis of last determination: Ratio of actual costs and postwar replacement costs.

Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $788,559.59.

This allowance is all based on amortization of tank cars. Inasmuch as transportation facilities (except vessels) appear to be excluded from the benefits of the amortization section of the act, this allowance must be questioned. The total allowance on tank cars is $788,559.59.

SHIPBUILDING AND MANUFACTURING

Name: Pusey & Jones Co., Monroe, Mich.

Business: Shipbuilding, also manufacturing of parts for locomotives, tanks, and gun tractors.

Original amount claimed: $6,732,796.67.

Final amount claimed: $6,530,173.15.

Amount finally allowed: $4,007,964.81.

Date of last determination: May 29, 1923.

Amortization deducted on property discarded or sold: $3,832,528.72.

Amortization deducted on reduced replacement costs: $175,136.09.

Basis of last determination: Difference between costs and estimated postwar replacement costs, based on published ratios, also estimated residual values.

Amount based on solicitor's ruling and on sound engineering principles: $4,007,964.81.

The above allowance is not questioned.

MINING

Name: Ray Consolidate Copper Co., Ray, Ariz.
Business: Mining and production of copper.
Original amount claimed: $259,219.07.
Final amount claimed: $1,283,341.78.
Amount finally allowed: $919,310.77.
Date of last determination: July 23, 1924.
Amortization deducted on property discarded or sold: $158,604.34.
Amoritzation deducted on reduced replacement costs: $390,472.49.
Amortization deducted on value in use: $370,233.94.

Basis of last determination: Housing, on occupancy; tunneling and timbering on replacement costs; other facilities on residual sales value.

Amount based on solicitor's ruling and on sound engineering principles: $158,604.34.

Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $760,706.43.

The following points should be noted in connection with this allowance:

(1) This taxpayer is in the business of copper mining and smelting. The principal ore deposits consist of prophyry mines in Arizona.

(2) The original amount claimed is about 30 per cent of the amount finally allowed.

(3) The value-in-use percentage is based on the estimated sales value of the entire property.

(4) Amortization has not been determined on each specific facility as required by the solicitor's ruling of August, 1923.

(5) No investigation has been made as to the nature of postwar expenditures.

(6) Proper allowance has not been made for the salvage value of items retained in use.

(7) No investigation hs been made to determine whether war expenditures were for replacements or for additions.

(8) The value-in-use percentage has been applied to war cost less 1917 depreciation.

We have been obliged in this case to question not only the amortization allowed on items retained in use, which has been determined in a manner contrary to the solicitor's ruling, but also the amortization allowed on the lowered postwar replacement costs of mine-development work.

In this connection the following inconsistencies in the bureau's methods should be noted:

On February 1, 1924, in the case of the Anaconda Copper Mining Co., amortization on development costs was denied.

On July 23, 1924, in this case of the Ray Consolidated Copper Co., amortization on development costs was allowed.

On January 21, 1925, in the case of the United Verde Extention Mining Co. amortization on development costs was allowed.

On May 28, 1925, in the case of the Cleveland Cliffs Iron Co., amortization on development costs was denied.

Inasmuch as it appears that a legal opinion was rendered in the last-named case, we must question the allowances made in the case of the Ray Consolidated Copper Co. on this basis.

IRON AND STEEL

Name: Republic Iron & Steel Co , Youngstown, Ohio.
Business: Manufacturing of steel products.
Original amount claimed: $5,153,302.49.
Final amount claimed: $5,148,798.61.
Amount finally allowed: $3,341,998.73.
Date of last determination: January 27, 1923.
Amortization deducted on property discarded or sold: $174,918.51.
Amortization deducted on value in use: $3,167,080.22.

Basis of last determination: Ratio of war-time capacity to average postwar production and use.

Amount based on solicitor's ruling and on sound engineering principles: $174,918.51.

Amount not based on solicitor's ruling: $3,167,080.22.

NOTE.—This case is similar to other steel cases and need not be discussed.

Value in use is based on the ratio of average production for 1921, 1922, and 1923 (estimated), to war capacity. It is obvious that this allowance should be recomputed as in the United States Steel case.

SHIPBUILDING

Name: Saginaw Shipbuilding Co., Saginaw, Mich.
Business: Shipbuilding.
Original amount claimed: $1,239,757.72.
Final amount claimed: $1,239,757.72.
Amount finally allowed: $1,234,763.13.
Date of last determination: April 12, 1922.
Amortization deducted on property discarded or sold: $1,234,763.13.
Basis of last determination: Difference between cost and sale price.
Amount based on solicitor's ruling and on sound engineering principles: $1,234,763.13.
NOTE.—This allowance is not questioned being based on actual sales price.

Name: Seattle North Pacific Shipbuilding Corporation, Seattle, Wash.
Business: Building of 10 steel ships for United States Shipping Board Emergency Fleet Corporation.
Original amount claimed: $1,828,664.65.
Final amount claimed: $1,828,664.65.
Amount finally allowed: $1,828,664.65.
Date of last determination: June 20, 1921.
Amortization deducted on property discarded or sold: $1,828,664.65.
Basis of last determination. Difference between cost and sale price.
Amount based on solicitor's ruling and not on sound engineering principles: $1,828,664.65.
NOTE.—This allowance is not questioned, being based on sale price.

IRON AND STEEL

Name: Sharon Steel Hoop Co., Sharon, Pa.
Business: Steel products.
Original amount claimed: $3,630,932.24.
Final amount claimed: $3,629,154.55.
Amount finally allowed: $736,999.72.
Date of last determination: June 1, 1923.
Amortization deducted on property discarded or sold: $29,313.65.
Amortization deducted on reduced replacement costs: $697,973.85.
Amortization deducted on value in use: $9,712.22.
Basis of last determination: Excess postwar capacity, difference between depreciated cost and postwar replacement cost, and difference between depreciated cost and estimated salvage value.
Amount based on solicitor's ruling and on sound engineering principles: $736,999.72.
NOTE.—This allowance is practically all on discarded material for lowered postwar replacement costs and is not questioned.

CHEMICALS AND DYES

Name: Sherwin-Williams Co., Cleveland, Ohio.
Business: Manufacturing paints, varnishes, dry colors, dyes, and chemical products.
Original amount claimed: $802,081.85.
Final amount claimed: $802,081.85.
Amount finally allowed: $591,244.37.
Date of last determination: January 18, 1924.
Amortization deducted on property discarded or sold: $218,645.05.
Amortization deducted on value in use: $372,599.32.
Basis of last determination: Production ratios and pounds of water evaporated at steam plant.
Amount based on solicitor's ruling and on sound engineering principles: $218,645.05.
Amount not based on solicitor's ruling: $372,599.32.
The following points should be noted in connection with this case:
(1) Taxpayer is a manufacturer of paints, varnishes, dyes, and chemicals. The amortization allowance on discarded facilities is not questioned.
(2) The original claim of taxpayer is about 40 per cent in excess of the final allowance.

(3) The value in use percentage is, in general, based on the ratio of average production for 1921, 1922, and 1923 to the war capacity. The percentage is obtained by departments. In general the 1923 figures show a reasonably full use of the war facilities; for instance, the department B of the paint and varnish business of taxpayer shows the following production:

	Gallons produced		Gallons produced
1916	1,136,155	1920	1,576,899
1917	1,289,014	1921	917,018
1918	1,301,166	1922	1,431,964
1919	1,486,353	1923	1,790,253

Average, 1923, equals 1,379,755 gallons; capacity equals 1,576,869 gallons; value in use, per cent used, equals 87 per cent.

It is quite obvious from the above that the taxpayer could not have accomplished his 1923 production with a capacity of 1,576,869 gallons when the production of that year was over 200,000 gallons in excess of that capacity. We consider that the taxpayer has suffered no ultimate loss on items retained in use.

(4) The individual facilities of the taxpayer have not been examined as required by the solicitor's ruling of August, 1923.

(5) No investigation has been made as to the nature of postwar expenditures.

(6) Proper allowance has not been made for the salvage value of items retained in use.

(7) No investigation has been made to determine whether war expenditures were in the nature of replacements or of additions.

(8) Value in use percentage has been applied to war cost less 1917 depreciation.

OIL

Name: Sinclair Oil & Refining Co., New York, N. Y.

Business: Production and refining of oil.

Original amount claimed: $2,014,403.74.

Final amount claimed: $3,752,869.71.

Amount finally allowed: $2,236,512.20.

Date of last determination: July 11, 1924.

Amortization deducted on property discarded or sold: $750,331.16.

Amortization deducted on reduced replacement costs: $1,486,181.04.

Basis of last determination: Ratio of postwar replacement cost to actual cost, also difference between depreciated cost price and sales prices, both actual and estimated.

Amount based on solicitor's ruling and on sound engineering principles: $1,476,926.76.

Amount not based on solicitor's ruling: $759,585.44.

NOTE.—The allowances questioned in this case are those granted on transportation facilities. We understand that the solicitor has ruled that amortization be denied this taxpayer on pipe lines. The facilities and amounts allowed which are questioned follow:

Facilities:	Amortization allowed
Tank cars	$320,793.96
Sinclair, Cudahy pipe line	259,468.72
Sinclair Gulf Pipe Line Co	179,322.76
Total	759,585.44

The above allowances in our opinion are illegal and will not be discussed further.

SHIPBUILDING

Name: Skinner & Eddy Corporation, Seattle, Wash.

Business: Shipbuilding.

Original amount claimed: $4,752,108.62.

Final amount claimed: $4,752,108.62.

Amount finally allowed: $4,442,978.09.

Date of last determination: July 11, 1921.

Amortization deducted on property discarded or sold: $4,442,978.09.

Basis of last determination: Difference between depreciated cost and sale price.

Amount based on solicitor's ruling and on sound engineering principles: $3,027,085.74.

Amount not based on solicitor's ruling: $1,415,892.35.

NOTE. Value in use is not involved in this case, as amortization is based on sales price. A portion of the allowance must be questioned, however, on considerations which will be mentioned.

The Skinner & Eddy Corporation was organized in June, 1916. They engaged in extensive shipbuilding operations for the United States Shipping Board during the war. On December 5, 1919, the Skinner & Eddy Corporation sold its assets in the shipbuilding plant and land to the Skinner & Eddy Shipbuilding Co. The price paid was $1,000,000. The original cost of the land and assets was $5,602,109.85.

The amortization allowed on land alone was $1,000,892.35 on real estate costing $1,815,892.35. This amortization on land is contrary to the opinion of Solicitor Gregg as stated in the hearings. Furthermore this enormous reduction is not substantiated and must be questioned.

Machinery, buildings, and other assets bought for $275,000 were sold six months later for $600,000. The balance of $325,000 is questionable, for it is not believed that the sale of the Skinner & Eddy Corporation to the Skinner & Eddy Shipbuilding Co. is a bona fide sale.

FOODSTUFFS

Name: South Porto Rico Sugar Co., New York, N. Y.

Business: Cultivation of sugar cane and manufacturing and sale of raw sugar.

Original amount claimed: $495,224.27.

Final amount claimed: $1,521,684.46.

Amount finally allowed: $1,009,170.57.

Date of last determination: September 4, 1923.

Amortization deducted on reduced replacement costs: $1,009,170.57.

Basis of last determination: Application of ratios determining post-war replacement costs.

Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $1,009,170.57.

NOTE. In this case an allowance of $1,009,170.57 is made as amortization on costs of $5,009,727.90.

No field examination was ever made in this case. It is our contention that no engineer can make an accurate determination of amortization amounting to over one million dollars without even seeing any portion of the property to be amortized, and without ascertaining the necessary data as to replacement costs, obtaining in the specific locality, in this case, Porto Rico.

FOODSTUFFS

Name: Sperry Flour Co., San Francisco, Calif.

Business: Manufacturing of flour and cereals.

Original amount claimed: $447,997.84.

Final amount claimed: $2,757,636.80.

Amount finally allowed: $1,027,023.81.

Date of last determination: March 4, 1924.

Amortization deducted on value in use: $1,027,023.81.

Basis of last determination: Ratio of production and capacity during war period and production during 1921, 1922, and 1923.

Amount not based on solicitor's ruling: $1,027,023.81.

The following points should be noted in connection with this allowance:

(1) The facilities upon which amortization is claimed are those necessary in the manufacture of flour and cereals. All facilities are retained in use. Engineer's report of Engineer Carlson, about 1920, denied all amortization on the basis that the facilities were in use. However, the final allowance is based on a value in use of 55 per cent for all the facilities in the 10 plants of the taxpayer.

(2) The original claim of the taxpayer was about 45 per cent of the amount finally allowed.

(3) The value in use percentage is derived for all facilities on the weighted average of the value in use for 4 out of 10 plants of the taxpayer. The value in use at each of these 4 plants is the ratio of production for 1921, 1922, and 1923 to war capacity.

(4) The individual items have not been examined as required by the solicitor's ruling of August, 1923.
(5) No investigation has been made as to the nature of postwar expenditures.
(6) Proper allowance is not made for the salvage value of items retained in use.
(7) No investigation is made to determine whether war expenditures were for replacements or for additions.
(8) Value in use per cent is applied to war cost less 1917 depreciation.

OIL

Name: Standard Oil Co. of Indiana, Chicago, Ill
Business: Production and refining of oil.
Original amount claimed: $3,952,000.
Final amount claimed: $2,887,867.43.
Amount finally allowed: $2,876,318.24.
Date of last determination: September 26, 1923.
Amortization deducted on property discarded or sold. $1,418,020.49.
Amortization deducted on reduced replacement costs: $1,380,385.91.
Amortization deducted on value in use: $77,911.84.
Basis of last determination: Difference between war-time cost and estimated salvage value; also difference between war-time cost and replacement cost; also estimated residual value.

Amount based on solicitor's ruling and on sound engineering principles: $2,349,-135.56.

Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $527,182.68.

The principal allowance questioned in this case is that granted on the tank steamer *William P. Cowen* in the amount of $499,270.84. It appears that the vessel was contracted for before April 6, 1917, inasmuch as expenditures on account of its construction, amounting to $154,980, were made before that date. In the case of a vessel contracted for prior to the war, it is our contention that only such amortization can be granted as can be based on costs of changes and extras made for war purposes.

HARDWARE

Name: The Stanley Works, New Britain, Conn.
Business: Manufacture of machine-gun parts, gas-mask parts, fuse sockets, and other special parts
Original amount claimed: $790,440.10.
Final amount claimed: $790,440.10.
Amount finally allowed: $715,305.01.
Date of last determination: August 10, 1921.
Amortization deducted on property discarded or sold: $556,362.65.
Amortization deducted on value in use: $158,942.36.
Basis of last determination: Difference between cost and sale price and estimated salvage values in going business.

Amount based on solicitor's ruling and on sound engineering principles: $556,362.65.

Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $158,942.37.

NOTE.—The following points should be noted in connection with this allowance.
(1) The facilities on which amortization is allowed consist of those necessary in the manufacture of rifle and pistol parts, hand grenade parts, Liberty motor parts, etc., such as presses, machine tools, motors, generators, buildings, open-hearth furnace, etc. The greater portion of the claim is based on discarded value which allowance is not questioned.
(2) The amount claimed was about 10 per cent in excess of amount finally allowed.
(3) The basis of the value in use is a direct estimate by the examining engineer. The estimate in most cases is very rough and obscure. For instance, a fence is listed as 50 per cent in use. It would appear to us that a fence is either in full use or else discarded, or a portion of same discarded. Other items which are questionable on a direct estimate are:

	Per cent in use		Per cent in use
Piping	25	Hot-water system	20
Do	10	Electric wiring	30
Steam piping	30		

No real bases for the above estimates are shown.

(4) The specific facilities of the taxpayer have been examined.

(5) No mention is made of the nature of postwar expenditures.

(6) Salvage value is not taken into account in determining value in use.

(7) The nature of war expenditures is not investigated to determine whether they were for replacement or for additions.

(8) Value in use precentage is applied to war cost less 1917 depreciation.

IRON AND STEEL

Name: Steel and Tube Co. of America, Chicago, Ill.

Business: Manufacturing of pig iron, steel pipe, and other steel products.

Original amount claimed: $2,114,151.37.

Final amount claimed: $5,889,013.06.

Amount finally allowed: $5,232,176.46.

Date of last determination: October 13, 1923.

Amortization deducted on property discarded or sold: $5,232,176.46.

Basis of last determination: Difference between cost and sales price.

Amount based on solicitor's ruling and on sound engineering principles: $5,232,176.46.

NOTE.—This allowance is not questioned, being based on the sale price to the Youngstown Sheet & Tube Co.

FOODSTUFFS

Name: Swift & Co., Chicago, Ill.

Business: Meat packers.

Original amount claimed: Not stated.

Final amount claimed: $1,464,006.41.

Amount finally allowed: $809,353.65.

Date of last determination: March 10, 1924.

Amortization deducted on property discarded or sold: $405,334.61.

Amortization deducted on value in use: $404,019.04.

Basis of last determination: Ratio of war-time production and average postwar production.

Amount based on solicitor's ruling and on sound engineering principles: $405,334.61.

Amount not based on solicitor's ruling, $404,019.04.

The following points should be noted in connection with this allowance:

(1) The taxpayer is a meat packer and is also engaged in the production of numerous by-products. The facilities amortized can be classified under the following heads:

(*a*) Soap warehouse.

(*b*) Power plant.

(*c*) Butterine department.

(*d*) Blood albumen department.

Allowances on the basis of property discarded or sold are not questioned.

(2) The original claim of taxpayer is not stated.

(3) The value in use percentage is, in general, determined from the ratio of 1921, 1922, and 1923 production to war production. For instance, the following figures are given as to soap production:

Pounds of soap produced:		Pounds of soap produced—Continued	
1915	52, 968, 300	1920	154, 636, 100
1916	93, 522, 100	1921	105, 996, 000
1917	133, 771, 800	1922	127, 587, 200
1918	179, 479, 476	1923	138, 977, 784
1919	141, 338, 300		

Average 1921, 1922, and 1923 equals 124,186,995 pounds. This is 70 per cent of the 1918 production, and a value in use of 70 per cent is therefore allowed. As a matter of fact, based on 1923 production alone, the value in use would be 77 per cent.

As the taxpayer's business gives every evidence that the facilities installed will be eventually used, we do not consider that this taxpayer will suffer any ultimate loss due to lowered value in use.

(4) The specific facilities of taxpayer have not been examined in conformity with solicitor's ruling of August, 1923.

(5) No investigation has been made as to the nature of postwar expenditures.
(6) Proper allowance has not been made for the salvage value of items retained in use.
(7) No investigation has been made to determine whether war expenditures were for replacements or for additions.
(8) Value in use per cent has been applied to war cost less 1917 depreciation.
General note:
The following statement is noted in the engineer's report:
"Soap as an article of manufacture by itself is not considered by the unit as an essential article which contributed to the prosecution of the war * * * ."
In spite of this policy, about one year previous, amortization had been allowed Procter & Gamble on soap-making facilities.

Name: Swift & Co., Chicago, Ill. (Libby, McNeill & Libby).
Business: Food packers.
Original amount claimed: $894,083.23.
Final amount claimed: $894,083.23.
Amount finally allowed: $555,304.45.
Date of last determination: March 4, 1924.
Amortization deducted on value in use: $555,304.45.
Basis of last determination: Ratio of 1918 capacity to actual average output for 1921, 1922, and 1923; also, in case of vessels, ratio of tonnage values.
Amount not based on sound engineering principles and not specifically condemned by solicitor's ruling: $555,304.45.
Two vessels were contracted for prior to April 6, 1917, but amortization was allowed on same. Engineer has used average postwar production throughout for 1921, 1922 and 1923. No facilities have been discarded. The specific items have not been examined.

MUNITIONS

Name: Symington Machine Corporation, Rochester, N. Y.
Business: Manufacture of war munitions.
Original amount claimed: $696,578.25.
Final amount claimed: $696,578.25.
Amount finally allowed: $696,578.25.
Date of last determination: January 6, 1923.
Amortization deducted on property discarded or sold: $696,578.25.
Basis of last determination: Difference between costs and taxpayer's estimate of salvage value.
Amount based on solicitor's ruling and on sound engineering principles: $696,578.25.
NOTE. This taxpayer was engaged in the manufacture of shrapnel shells during the war period. The amortization allowed is on munitions machinery only and is based on the difference between cost and discarded or sale value. The allowance is not, therefore, questioned.

SHIPBUILDING

Name: Terry Shipbuilding Co., Savannah, Ga.
Business: Shipbuilding.
Original amount claimed: None stated.
Final amount claimed: $1,417,939.89.
Amount finally allowed: $1,340,531.49.
Date of last determination: July 5, 1921.
Amortization deducted on property discarded or sold: $1,340,531.49.
Basis of last determination: Estimated residual values as of June, 1921.
Amount based on solicitor's ruling and on sound engineering principles: $1,340,531.49.
NOTE.—This allowance can not be questioned from the data at hand, being based on discarded value. Investigation should have been made, however, as of March 3, 1921, to determine if this plant was converted to peace time uses after date of examination on July 5, 1921.

Name: Union Construction Co., San Francisco, Calif.
Business: Shipbuilding.
Original amount claimed: $861,900.
Final amount claimed: $1,814,980.44.
Amount finally allowed: $1,411,551.26.

Date of last determination: June 3, 1924.

Amortization deducted on property discarded or sold: $1,411,561.26.

Date of last determination. Difference between depreciated cost and sales price.

Amount based on solicitor's ruling and on sound engineering principles: $1,411,561.26.

NOTE. We have insufficient data to question the above allowance which is based on sales price. It is a question of whether the sale is bona fide or not.

It appears that "Peake & Johnson" a partnership incorporated their business on April 19, 1918. The principal stockholders in this new company were Peake & Johnson. On July 18, 1922, the company sold back its entire plant to Peake and Johnson as individuals. The total cost of assets sold was $1,944,980.44. The price received was $100,000, or less than 6 per cent of cost. We doubt very much if this sale should have been considered bona fide for determining amortization.

MINING

Name: United Verde Extension Mining Co., New York City- Jerome, Ariz.

Business: Copper mining.

Original amount claimed: $4,127,142.10.

Final amount claimed: $4,072,303.08.

Amount finally allowed: $3,322,648.92.

Date of last determination: January 24, 1925.

Amortization deducted on value in use: $3,322,648.92.

Basis of last determination: Ratio war-time production to average postwar production.

Amount based on solicitor's ruling and on sound engineering principles: $3,322,648.92.

NOTE.—The following general points should be noted in connection with this allowance:

(1) The nature of the facilities amortized may be classified as follows:

(*a*) Smelter and smelter plant, including crushing plant, reverberatory furnace, blast furnace, converter plant, power house, shops, etc.

(*b*) Tunnels and shafts, including over 13,000 feet of tunnel, one intermediate shaft, one hoisting shaft, timbering, guides, hoisting apparatus, track, ore car, and miscellaneous equipment.

(*c*) Arizona extension railroad, including ties, tracks, culverts, locomotives, and equipment.

(*d*) Additional mine equipment, including buildings, assay and engineering equipment, machinery, auto trucks, shop tools etc.

Attention is specially called to the expenditures for shafts and tunnels which are development expenses and on which amortization has been allowed under date of November, 1924. Under date of February, 1924, the report on amortization for the Anaconda Copper Co., stated that development costs were not allowed. This appears to be another case of inequity and inconsistency in handling cases in the same industry.

(2) The amount originally claimed was about 25 per cent greater than the amount finally allowed.

(3) The value in use percentage has been based on the ratio of the capacity of a plant necessary for postwar needs (150,000 tons) to the capacity of the war plant (300,000 tons). The following are the production figures:

	Tons mined		Tons mined
1915	10,640	1920	174,238
1916	80,781	1921	70,075
1917	116,399	1922	144,647
1918	155,703	1923	182,761
1919	96,522	1924 (2 months)	35,714

The value in use is taken at 50 per cent.

It will be noted that the war capacity of 300,000 tons is a rated capacity and the plant never did in fact ever reach this figure. The highest tonnage mined by taxpayer in the war period was 155,703 tons in 1918. We have no facts sufficient to challenge the 300,000 tons capacity used. It is obvious that the taxpayer increased his plant to a considerable extent during the war period, but the completion of the facilities installed might have been at too late a date to be reflected in production.

It will be noted that the 1923 production was 182,761 tons, or over 60 per cent of capacity. But it has been repeatedly shown that in such industries as steel, copper, etc., a margin of 15 to 20 per cent is required in capacity over production. Adding 15 per cent to the 1923 production, a capacity for 1923 of 210,175 tons would be required, which would show a value in use of 70 per cent.

Now, the production of copper in the United States in 1924 exceeded the 1923 production by 13 per cent. It is then evident that the excess capacity of this taxpayer is not large, in fact, not larger than a policy of expansion might dictate. We believe the amortization in the case should be confined to discarded items.

Further, we do not see how a lowered value in use can be given to shafts and tunnels as such construction must be eventually necessary if the ore is to be recovered at all.

(4) The specific facilities of this taxpayer were not examined, but a lump sum allowance of 50 per cent was applied to war costs.

(5) The engineer states that no "substantial additions for the purpose of increasing copper producing capacity" were made subsequent to 1919.

(6) No allowance is made on account of the salvage value of items in use.

(7) No mention is made of whether expenditures were in the nature of replacements or additions. We concede that the greater part of the expenditures must have been for additions.

(8) The value in use percentage is applied to war cost less 1917 depreciation.

(9) Amortization amounting to $252,756.97 is allowed on the transportation facilities of the Arizona Extension Railroad. We believe this contrary to the solicitor's ruling.

We desire also to draw attention to the fact that the engineer reporting on this claim first allowed an amortization deduction of $2,373,428.09 based on a residual value of 65 per cent.

Later the conferees of the engineering division, Mr. A. R. Shepherd and Mr. C. C. Griggs overruled this allowance and granted the taxpayer amortization of $3,322,648.92, an increase of nearly $1,000,000 based on a value in use of 50 per cent.

We have had numerous instances of the improper allowances made by the above conferees in metals and nonmetals valuations. This report shows that their methods of bargaining were not confined to metals, but also were applied to amortization.

IRON AND STEEL

Name: United States Steel Co., New York, N. Y.

Business: Steel and steel products, etc.

Original amount claimed: $83,065,169.21.

Final amount claimed: $86,411,952.61.

Amount finally allowed: $55,063,312.60.

Amortization deducted on property discarded or sold: $9,783,244.02.

Amortization deducted on reduced replacement costs: $16,608,264.87.

Amortization deducted on value in use: $28,671,803.71.

Basis of last determination: Ratio of average production for 1921, 1922, and 1923 (estimated) to war capacity.

Amount based on solicitor's ruling and on sound engineering principles: $27,136,899.99.

Amount not based on solicitor's ruling: $27,926,412.61.

NOTE. Amortization is allowed on both lowered post-war replacement cost and lowered value in use.

The case has been fully discussed in the hearings before the committee.

MINING

Name: Utah Copper Co., Salt Lake City, Utah.

Business: Copper mining.

Original amount claimed: $4,855,691.69.

Final amount claimed: $5,232,820.63.

Amount finally allowed: $2,783,636.89.

Date of last determination: June 10, 1924.

Amortization deducted on reduced replacement costs: $13,490.36.

Amortization deducted on value in use, $2,770,146.53.

Basis of last determination: Assumed residual values, estimated price at which certain facilities could be sold or salvaged.

Amount based on solicitor's ruling and on sound engineering principles: $46,144.98.

Amount not based on solicitor's ruling: $2,737,491.91.

The following points should be noted in connection with this allowance:

(1) The taxpayer is in the business of mining copper. Nearly all amortization is allowed on a lowered value in use basis.

(2) The original claim of taxpayer was about 80 per cent more than the amount finally allowed.

(3) The value in use percentage is based on the worth of the entire property from a sales standpoint. The engineer claims that the value in use is less than the salvage value. A study of the following figures will show, however, that taxpayer had full need of his facilities in 1923 and suffered no ultimate loss.

Year	World production	Production of blister copper in short tons		Year	World production	Production of blister copper in short tons	
		United States production	Utah Copper Co. production			United States production	Utah Copper Co. production
1913	1,072,674	614,255	58,971	1919	1,069,437	604,642	52,544
1914	1,011,939	279,133	57,845	1920	1,078,245	635,248	50,644
1915	1,188,172	712,126	71,199	1921	591,296	238,430	12,255
1916	1,533,294	971,123	93,766	1922	987,540	511,970	41,389
1917	1,579,675	961,016	97,919	1923	1,436,000	809,000	98,656
1918	1,569,523	969,637	91,016				

Utah Copper Co. had a greater production of copper in 1923 than ever before in its history.

(4) Amortization has not been determined on each specific facility as required by the solicitor's ruling of August 1923.

(5) No investigation has been made as to the nature of postwar expenditures.

(6) Proper allowance has not been made for the salvage value of items retained in use.

(7) No investigation has been made to determine whether war expenditures were for replacements or for additions.

(8) The value in use percentage has been applied to war cost less 1917 depreciation.

(9) The taxpayer has been allowed amortization on the facilities of a subsidiary railroad company, the Bingham & Garfield Railway Co., in the amount of $310,188.77. This is illegal, as admitted even by the bureau.

SHIPBUILDING

Name: Western Pipe & Steel Co., San Francisco, Calif.

Business: Shipbuilding and steel fabrication.

Original amount claimed: $1,433,399.34.

Final amount claimed: $1,474,599.71.

Amount finally allowed: $1,440,174.61.

Date of last determination: May 12, 1922.

Amortization deducted on property discarded or sold: $1,440,174.61.

Basis of last determination. Sales price and salvage values.

Amount based on solicitor's ruling and on sound engineering principles: $1,440,174.61.

NOTE.—This allowance has not been questioned, being based on sales price.

MACHINERY MANUFACTURING

Name: Westinghouse Air Brake Co., Pittsburgh, Pa.

Business: Manufacturing of air brakes, railroad switches, and signals.

Original amount claimed: $702,820.81.

Final amount claimed: $2,403,968.71.

Amount finally allowed: $1,471,369.24.

Date of last determination: March 1, 1924.

Amortization deducted on property discarded or sold: $83,569.27.
Amortization deducted on value in use: $1,387,799.97.
Basis of last determination: Houses, on rents collected, compared to theoretical rentals. Plants, ratio of postwar production to war-time production.
Amount based on solicitor's ruling and on sound engineering principles: $83,569.27.
Amount not based on solicitor's ruling: $1,387,799.97.
NOTE.—This case has been discussed before the committee.

OIL

Name: The Texas Co.
Business: Oil production and pipe line transportation.
Original amount claimed: $2,727,561.93.
Final amount claimed: $2,727,561.93.
Amount finally allowed: $2,431,720.43.
Date of last determination: September 30, 1924.
Amortization deducted on property discarded or sold: $271,298.23.
Amortization deducted on reduced replacement costs: $2,160,422.20.
Basis of last determination: Postwar replacement cost and difference between depreciated cost and sales price or salvage value.
Amount based on solicitor's ruling and on sound engineering principles: $131,527.92.
Amount not based on solicitor's ruling: $2,300,192.51.
NOTE.—It will only be necessary to discuss in detail the allowance to "common carrier" pipe lines in this case, inasmuch as this constitutes the major portion of the allowance.
The following amounts have been allowed on pipe lines:

Texas Pipe Line Co	$1, 889, 053. 55
Texas Pipe Line of Oklahoma	107, 016. 76
Total	1, 996, 070. 31

The above allowance is clearly illegal, and is now so admitted by the bureau.

MINING

Name: Westmoreland Coal Co., Philadelphia, Pa.
Business: Production of coal and manufacturing of ammonia.
Original amount claimed: $422,526.
Final amount claimed: $787,2[illegible].62.
Amount finally allowed: $508,0[illegible].12.
Date of last determination: December 18, 1923.
Amortization deducted on property discarded or sold: $508,093.12.
Basis of last determination: Difference in residual costs and sales price.
Amount based on solicitor's ruling and on sound engineering principles: $508,093.12.
NOTE.—The above allowance is not questioned, being based on sales price.

SHIPPING

Name: Winnett Operating Co., New York, N. Y.
Business: Operation of ships.
Original amount claimed: $705,886.54.
Final amount claimed: $705,886.54.
Amount finally allowed: $576,835.27.
Date of last determination: March 1, 1924.
Amortization deducted on property discarded or sold: $576,835.27.
Basis of last determination: Difference between depreciated costs and sale price.
Amount based on solicitor's ruling and on sound engineering principles: $576,835.27.
NOTE.—This allowance is based on actual sale price and is not questioned.

SENATE COMMITTEE INVESTIGATING
BUREAU OF INTERNAL REVENUE,
Washington, D. C., February 1, 1926.

To: Senator Couzens.
From: L. C. Manson, counsel.
Subject: Miscellaneous reports from staff.

The attached are reports which have been submitted to me by various members of the staff of this committee since the committee discontinued its hearings on May 31, 1925. None of these reports are in the printed hearings which have been reported to the Senate, and I recommend that these reports, together with the amortization reports, be reported to the Senate as a supplement to the partial report which has been made by this committee.

Respectfully submitted.

L. C. MANSON, *Counsel.*

SEPTEMBER 10, 1925.

Mr. L. C. Manson, counsel Senate Committee for Investigation Bureau of Internal Revenue. Office Report No. 45.
Subject: Report on anthracite industry.

INTRODUCTION

Information and data obtained from the Income-Tax Bureau has been so incomplete and unsatisfactory that a study of the anthracite industry from a Federal taxation standpoint would be impossible. It has been necessary, therefore, to look elsewhere for such information. This report is based largely on data obtained from the report of the United States Coal Commission, dated September 22, 1923, entitled "Investments and profits in anthracite mining." This commission obtained a large amount of material from the books of the anthracite companies, through its auditors and engineers and from these statistical records a compilation (Exhibit C) has been prepared which discloses much valuable taxation information. Reference will also be made to a report dated July 6, 1925, on "Premium price of anthracite," by the Federal Trade Commission; also to the report of the engineers' advisory valuation committee of the United States Coal Commission on "Valuation of coal mining properties in the United States," published in February, 1924.

From the Income-Tax Bureau statistical reports were obtained for leading anthracite companies both from the coal valuation section of the engineering division and from the audit division, which are summarized in Exhibit D. Some statistical information has been obtained also from the special assessment division which is summarized in Exhibit E. The data obtained from the bureau will be used herewith only for comparative purposes.

THE ANTHRACITE INDUSTRY

Quoted from Federal Trade Commission report, dated July 6, 1925.

"The anthracite mining region of Pennsylvania covers an area of less than 500 square miles in the northeast part of the State, and is divided into four principal fields, viz: The Wyoming, or northern, the Lehigh or eastern middle, the Shamokin or western middle, and the Schuylkill, or southern. It is the only important anthractie field in this country.

"Of the total annual production amounting on the average to more than 88,000,000 net tons for the 10-year period 1914 to 1923, over 70 per cent is produced by eight large companies which, because they formerly were owned by and still are more or less closely affiliated in economic interest with the railroads tapping the anthractie territory, and known in the trade as 'railroad companies.' The output of these companies is usually designated as 'company coal.' The remaining 25 or 30 per cent of the total annual production comes from the mines of over 100 companies, which are not affiliated in ownership with the anthracite-carrying railroads, and which are for this reason, known as 'independent companies' or 'independents.'

"Anthracite is, therefore, a limited and closely held natural resource. Its production has shown no consistent tendency to increase during the past 10 years, although the demand for it grows from year to year. It is chiefly adapted to domestic use, and is sold over a very wide territory in response to an inelastic household demand which at all times presses closely upon production. In times of shortage, this demand assumes panic proportions.

"Of the total production of both the 'railroad' and the 'independent' companies about 70 per cent is made up of pea and of sizes larger than pea. The latter are known in the trade as 'domestic sizes' because they are consumed very largely by householders. The pea size is now sometimes called a domestic size, but not in this report. The remaining 30 per cent, or thereabouts, comprising what are known as 'steam sizes,' which are consumed by industrial power plants and large heating plants. The domestic and pea sizes, representing the principal product, are normally sold at prices yielding a profit over and above their production cost, while the steam sizes, which are a by-product, must be marketed in price competition with bituminous coal, and are generally sold at the mine for less than the average production cost of anthracite."

ANTHRACITE COMPANIES REPORTED BY UNITED STATES COAL COMMISSION

Railroad coal companies.—"The 'railroad companies' may be briefly defined as a group of coal producing and distributing companies owned by eight interests that are closely connected with railroads located in the anthracite region,' as follows:

1. Pennsylvania Coal Co. and Hillside Coal & Iron Co.
2. Lehigh Valley Coal Co. and Coxe Bros. & Co.
3. Philadelphia & Reading Coal & Iron Co.
4. Scranton Coal Co. and Elk Hill Coal & Iron Co.
5. Lehigh & Wilkes-Barre Coal Co.
6. Lehigh Coal & Navigation Co., Cranberry Creek Coal Co., and Alliance Coal Mining Co.
7. Hudson Coal Co., Delaware & Hudson Co. Coal Department, and Northern Coal & Iron Co.
8. Delaware, Lackawanna & Western Railroad Coal Department and Glen Alden Coal Co.

Large independent coal companies.—Maderia Hill interests: The Colonial Colliery Co., Horleigh-Brookwood Coal Co., Thomas Colliery Co., Wilkes-Barre Colliery Co., and Greenough Red Ash Coal Co.

Wentz interests: Maryd Coal Co., Upper Lehigh Coal Co., Midvalley Coal Co., J. S. Wentz Co., and Girardville Mining Co.

The Temple Coal Co., Lackawanna Coal Co., and Mount Lookout Coal Co.

Dodson interests: Locust Mountain Coal Co. and Charles M. Dodson & Co.

M. A. Hanna & Co. interests: Susquehanna Collieries Co. and Lytle Coal Co.

Kingston Coal Co.

Pardee Bros & Co.

THE ANTHRACITE COMBINATION

Quoted from Federal Trade Commission report, dated July 6, 1925:

"Apparently part of the present abnormal situation in the anthracite industry is due to the ownership of vast areas of undeveloped coal lands by a few large railroad coal companies. In the early history of the industry the anthracite operators were granted power both to mine and to provide transportation for their output. As early as 1833 a committee of the Pennsylvania State senate reported that a few interests were able to 'lock up at pleasure the resources of the whole valley or community.' To correct this situation the legislature began limiting in the charter of transportation companies the area of coal-bearing lands that they might hold, but in 1869 it practically reversed this policy by authorizing transportation companies to own the stocks and bonds of mining companies. The Philadelphia & Reading Railway Co., through its subsidiary, the Philadelphia & Reading Coal & Iron Co., soon became the largest owner of coal lands and the most important producer in the anthracite industry. As early as 1891 its annual report stated that it owned 'at least 50 per cent of the entire deposit remaining unmined.' Other railroads, such as the Central Railroad of New Jersey, the Lehigh Valley Railroad, the Delaware, Lackawanna & Western, the Delaware & Hudson, the Erie, and the Pennsylvania, also acquired control of extensive anthracite mining property, so that the anthracite railroads taken together came to own over 90 per cent of the available coal in the ground.

"To avoid competition among themselves these railroad coal companies made various agreements from time to time effecting the prices of the anthracite tonnage to be marketed. They maintained their control of anthracite transportation and distribution by hindering other railroads from entering the field and through purchase contracts with independent operators whereby the output of the latter was acquired by the railroad companies. The mine prices paid the independents by the railroads ranged from 35 per cent of the price received at New York tidewater, under the early contracts, up to 60 per cent generally in 1892. In 1898, when a large number of these 60 per cent contracts expired, many independent operators who were dissatisfied with the transportation and marketing conditions demanded lower freight rates or better prices, and a new company was formed to build a competing railroad to tidewater. This project was backed by independent operators. In order to prevent this, the anthracite railroads, in the language of the United States Supreme Court, 'combined together for the purpose of shutting out the proposed railroad and preventing competition with them in the transportation of coal in competition with their own controlled coal in the markets of other States.'

"The plan devised to prevent this threatened competition was to gain control of the mines of the chief independent operator backing this new railroad project. The entire capital stock of the Temple Iron Co., which was used to make this purchase, was owned jointly by the Reading, the Lehigh Valley, the Central of New Jersey, the Lackawanna, the Erie, and the New York, Susquehanna & Western Railroad Co. After this, most of the remaining independent operators made contracts with the railroad companies, acting in concert, by which they sold their output at 65 per cent of the tidewater price.

"During this period also the large railroad coal companies steadily absorbed many of their competitors. The largest combination was formed by the Reading interests, which acquired control of the Central Railroad of New Jersey and with it the control of its subsidiary company, the Lehigh & Wilkes-Barre Coal Co.

"Attempts to break the control of the railroads over the anthracite industry have been made under three statutes, namely, (1) the act to regulate commerce, of 1887, which among other things prohibited railway pools and provided that rates must be reasonable and not discriminatory; (2) the Hepburn Act of 1906, which amended and strengthened the said act of 1887 and contained, in particular, the so-called 'commodities clause' prohibiting railroads generally from transporting in interstate commerce commodities which they produced or owned; and (3) the Sherman Antitrust Act of 1890, which prohibited restraints of trade and monopolies in interstate commerce."

VALUE OF THE INDUSTRY

Original cost.—"The commission was unable to obtain figures of the original investment; neither the records of the present operating companies nor the resources of the commission were adequate for this purpose. As has been found by the Interstate Commerce Commission in the valuation of the railroads, accurate records of original cost in many instances do not exist. The most that the present commission has been able to do is to set down the items of appreciated value which could be identified on the books, and it is probable that other appreciations of value not identified by the accountants hav[e b]een placed on the books even during the life of the present operating companies."

Quoting from report of engineers' advisory valuation committee:

"Cost, which is urged as representing the actual investment in a property, is no criterion of value; the great bulk of the antharcite lands were patented to individuals by the State of Pennsylvania from about 1795 to 1816, at from two to four dollars per acre * * * yet $4 per acre at 6 per cent compound interest from 1800 to date would amount to $5,200 per acre; more than the present value of the lands * * *."

Original cost of lands of Lehigh Coal & Navigation Co.—"In the case of the Lehigh Coal & Navigation Co. the books showed the original cost of lands acquired in the pioneer days of the anthracite industry. The company has a continuous corporate existence of over 100 years. Its first operations were on lands leased for an annual rental of one ear of corn. It early acquired some 6,000 acres of coal lands at a cost of $30,000. In later years further purchases of 2,940 acres of land were made at a cost of $1,382,000. The total original cost of its present holdings of 8,940 acres of coal lands was $1,412,000. This original cost has been written up by two revaluations. The first, made in 1871, increased the book value by $4,970,000. The second, made in 1917 for Federal tax purposes, added $10,060,000 to the value.

"In the meantime the depletion charged by the company has amounted to $3,685,000, or two and a half times the original cost of the lands. Yet the lands still stand upon its books at $12,757,000, or nine times their original cost.

"The company's business management is conservative and its depletion charge to-day is the lowest of all the large companies. Few advocates of the theory of original cost will ignore its period of pioneer losses and try to hold down the company to an investment of one ear of corn or even $30,000. On the other hand, its history illustrates vividly the increment in values that has accompanied the increased demand and rising price of anthracite.

"In contrast to the Lehigh Coal & Navigation Co., some other companies have bought their lands recently at current market prices."

It is evident from the above that approximations only for original cost figures for these properties can be obtained. A summary of values of "railroad" coal properties (Exhibit F) has been prepared from the Coal Commission data from which apparent costs of these properties totals $174,646,069.

Book values.—The values carried on the books of the "railroad" coal companies (see Exhibit F) as found by the field accountants of the commission represent in most instances a figure below present market value, as estimated by the engineers, but above original cost. In the case of the Pennsylvania Coal Co., the books reflect original cost figures, appreciation of $40,000,000 being shown in a memorandum account for tax purposes; in the summary; however, this item of appreciation is included as book value. A total book value of the "railroad" coal properties only is disclosed at $385,133,933.

"The book values of the companies examined by the commission's field accountants, after deducting outside investments, amount to $520,000,000 with working capital included counting the memorandum accounts of the Pennsylvania Coal Co., and Hillside Coal & Iron Co. as a part of the book value. The companies examined produced 85 per cent of the output and owned in fee 81 per cent of the coal. If they represent a like percentage of the total investment in anthracite mining, the book value would be in the neighborhood of $600,000,000 or $640,-000,000 working capital included." Value as of 1921.

Current market value.—"The commission has referred to market values as one of the bases of determining profits. In order to arrive at an estimate of market values, it secured without compensation the services of a committee of engineers who, through technical training and many years of experience as experts in the appraisement of coal-mining properties, were especially qualified.

"The method employed is that adopted by engineering experts in valuation of mining properties; that is, the basis being the present and the estimated future earnings. The objection to the valuation of properties in the anthracite field is that this basis is that of earnings derived from inherent monopolistic conditions, the uncertainty as to future mining costs and future realization margins—two factors highly speculative. Nevertheless, this method of valuation is that which is employed by the experts representing capitalists desirous of investing in anthracite mining properties, and is the accepted practice in such transactions involving value of particular tracts."

Quoting from report of engineers' advisory valuation committee:

"After a full consideration of all the above methods your committee, in fixing a general value of coal lands, has used as far as practicable the present value method for operating properties, considered as covering the 'available coal' being the probable future output for 40 years; all coal in any district not included in the 40-year output is classed as reserves and the method of its appraisal is hereinafter explained."

"*Data.*—We requested, from data collected by the United States Coal Commission, Federal Trade Commission, and by the United States Geological Survey, statements of tonnage by years to date; days worked operating cost (with royalty, depletion, depreciation, interest, and Federal taxes separate), returns from sales, and tonnage remaining, and anthracite divided into four fields, northern, eastern middle, western middle, and southern.

"*Basis of valuation.*—The weighted average of data for the years 1920 and 1921, where such is available, was used as base; first, because this was believed to fairly represent present conditions; second, any changes of conditions in costs would, we believe, be reflected in the realization; third, the data in the possession of the commission is most complete for these years. Where the 1920–21 earnings were unavailable or misleading the most reliable available data were used.

"As the total value of the properties is desired, costs are figured before royalty, depletion, depreciation, and interest charges; royalty in the case of leased and depletion in the case of fee lands represents the value of the undeveloped coal in the ground, depreciation the value of improvements and developments, and interest charges and profits the returns to capital used in operation. Federal taxes are a charge against income and must be deducted from the realization before it can properly be used in estimates of value.

"*Future tonnage* is estimated from consideration of past tonnage and of reserves in each district.

"*Value of operating property.*—From the above, the value of the operating properties is determined by discounting at 6 per cent compound interest the net yearly returns, as a varying annuity estimated for each field for the period noted, obtained by applying the values as above indicated per ton to the estimated tonnage for each year.

"*Value of reserves.*—The reserve tonnage is determined by the difference between the operating tonnage as above and the total estimated tonnage in each field; this is considered as a whole in each field as undeveloped coal; the value of this is based on either actual sales of virgin areas where such sales of recent date are available and sufficient to justify their general employment in the estimates, or lacking that, on the present value of the reserve coal at the present rates of royalty, but considered deferred for the life of the operating lands.

"*Total valuation.*—Based on the above, the total valuation is made up of the value of operating coal land and reserves, and includes development and equipment, as well as all land values, regardless of whether the ownership is in the operating company or the lands operated under lease.

"Reasonably complete data, as requested, were furnished by your statisticians, together with the commission's estimate of coal.

Field	Total coal remaining	Per cent recoverable	Recoverable coal remaining
Northern	3,276,763,000	67.0	2,195,431,000
Eastern middle	248,628,000	69.4	172,548,000
Western middle	3,573,025,000	58.1	2,075,928,000
Southern	9,256,260,000	49.0	4,535,567,000
Total	16,354,676,000		8,979,474,000

"From a study of past production, we estimate as a conservative basis of value that the field as a whole can increase by 1935 to about 100,000,000 gross tons per year, and hold this average production to the end of the 40-year period allowed for available coal, as shown on attached diagram.

"The reserves, mostly in the western, middle, and southern fields, are expected to hold the 100,000,000 tons output for about 10 years longer and then gradually decrease to 50,000,000 tons per year with a total life of about 70 years additional.

"As important factors in production, we estimate for the northern field a life of 50 years; for the eastern middle, 35 years; the western middle, 100; and the southern field, 110 years. All of these fields will, of course, produce coal long after the above limits, but in small quantities and of negligible present value.

"The western, middle, and southern fields will have to carry on after the other two fields cease to be important factors, owing to depth and to geological conditions, resulting in a much smaller percentage of domestic sizes, the coal from these fields is more costly to mine and brings less realization, all sizes; hence these fields are naturally only developed to carry the surplus demanded by the market over that furnished by the cheaper northern and eastern middle fields; but these more costly fields have the greatest reserves and can be expected to maintain a large production long after the more favored fields are exhausted.

"The average royalty paid on all coal sold was found to be 16.5 cents per ton, the average depletion 14.7 cents, and average depreciation charged on plant 10.8 cents.

"Valuing the available coal, plant, and improvements on the basis of the returns found from the commission's figures, discounted to the present time, and the reserves on probable margins deferred 40 years, we estimate the present value of the properties comprising the Pennsylvania anthracite field as follows:

Available recoverable tonnage	3,907,900,000
Reserves recoverable tonnage	5,071,600,000
Total recoverable tonnage	8,979,500,000
Present value of plant, improvements, and available tonnage	$843,500,000
Present value reserve tonnage	146,400,000
Total present value	989,900,000

EXHIBIT C, COMPILATION FROM REPORT OF UNITED STATES COAL COMMISSION

Statistical information has been prepared covering 10 years, 1913 to 1922, inclusive, from data obtained from the Report of the United States Coal Commission, arranged for the purpose of this report. The 10 years-period has been divided into three periods, pre-war (1913 to 1916, inclusive), war (1917 to 1918, inclusive) and postwar (1919 to 1922, inclusive). Average annual figures for these three periods are shown for production; capital stock; total assets; dividends paid; earned surplus at end of year; net income, as per book, adjusted; net income for coal operations, adjusted; depletion and depreciation. Per ton figures and percentage of adjusted net income, as per book, are shown for dividends paid, earned surplus, depletion, and depreciation. These figures are shown in detail and in total for the eight "railway" coal interests; in total for the 14 "independent" coal companies, and grand totals and percentages for all companies. Per ton and percentage figures for totals are obtained after proper eliminations and corrections when necessary by reason of detail data being missing.

NET INCOME

The commission accountants, finding that there was no uniform method of accounting among the companies, first obtained figures for net income as per books (including income from outside investments) and then made adjustments to bring the figures to a comparable basis. Net income figures were also obtained for coal operations only which were also adjusted to a comparable basis. The figures submitted are those after adjustments were made.

Adjusted net income for all companies reported

Period	Production (gross tons)	Average annual net income adjusted			
		As per books		For coal operations only	
		Amount	Cents per ton	Amount	Cents per ton
1913-1916, inclusive [1]	52,427,744	$16,316,746	31.12	$16,758,860	31.97
1917-1918, inclusive [1]	57,930,211	32,030,521	55.29	30,889,319	53.32
1919-1922, inclusive	52,376,070	29,848,848	56.99	29,597,437	56.51

[1] Data lacking for Delaware, Lackawanna & Western Coal Co.

It will be noted that the net income of anthracite companies almost doubled during and since the war over what it was during the pre-war period.

PROFITS

Quoting from the report of the United States Coal Commission:

"The principal facts found by the commission in its investigation of anthracite profits are:

"1. No average figure either of margin per ton or per cent return on investment can fairly represent the profit in anthracite mining. Because of great inequalities in cost and in selling arrangements some operators make very large profits and others very small profits. The margins per ton between cost and sales realization in ordinary times range from less than nothing to over $2 a ton. The per cent return on book value of investment in coal ranges all the way from a loss to 138 per cent (one independent operator, year 1917).

"2. There has been a very large increment in value, so that the lands are now worth on the market more than they used to be although a third of the coal is gone. The commission could not obtain the original cost of more than one or two of the properties. It did find that the present book values contain certain 'write-ups' or revaluations of assets amounting to at least $186,000,000, and in addition there were memorandum accounts kept for Federal tax purposes indicating further appreciation of $40,000,000."

Referring to Exhibit F, summary of values of "railway" coal properties, there will be noted the per cent return on investment in coal operations, as per books, for the "railroad" companies. This per cent return for the year 1921 would appear to vary from 2.1 per cent to 30 per cent, the average being 8.9 per cent. Based on the apparent costs of the properties the per cent return varies from 4.3 per cent to 137.2 per cent with average 19.6 per cent.

"3. The latest of the foregoing revaluations, however, was as of 1913. Since 1913 a further huge increment in market value has accrued to the owners of the property. A committee of engineers appointed by us estimates the present market value of mines and mineral as $989,000,000. The book values, allowing for companies and holdings not examined by the accountants, are in the neighborhood of $600,000,000. This indicates a further increment of hundreds of millions of dollars inuring to the owners if the engineers' estimates based on earnings are accepted.

"4. The profits are increasing. Total net income is increasing, dividends are increasing, and surpluses are increasing, earned surpluses as well as surplus arising through revaluations. The margin per ton is increasing."

DIVIDENDS

Table Exhibit C shows the dividends paid (exclusive of stock dividends) by the "railroad" and "independent" coal companies for the years 1913 to 1922, inclusive. Comparative percentages are shown on Exhibit G. Percentages are shown in cents per ton of coal produced, in per cent of par value of capital stock, and of adjusted net income. It will be noted that two of the "railroad" coal companies, the Philadelphia & Reading Coal & Iron Co. and the Scranton Coal Co., paid no dividends, and the Philadelphia & Reading Coal & Iron Co. paid little or no interest on advances made to it by the Reading Co., a holding company. Very large dividends paid in certain years by the Lehigh & Wilkes-Barre, the Pennsylvania, Hillside, and the Lehigh Valley, represented in part the distribution of accumulated surplus. The Lehigh Coal & Navigation Co., paying 8 per cent dividends regularly, largely derives its income from transportation.

The commission was unable to obtain a separation of the coal accounts and the railroad accounts of the Delaware, Lackawanna & Western Railroad Co. that would permit a statement of income from coal applied to investment from coal. It is a matter of common knowledge, however, that the business was highly profitable, and that the coal-mining department contributed largely to the prosperity of the combined enterprise. The dividends paid by the Delaware, Lackawanna & Western Railroad Co. have been as follows:

	Per cent		Per cent
1909:		1916	20
Cash [1]	70	1917	22½
Stock	15	1918	20
1910	20	1919	20
1911	[2] 55	1920	20
1912	20	1921:	
1913	20	Cash	18
1914	20	Stock	100
1915	20	1922	12

INCREASES IN SURPLUS ACCOUNTS

Further evidence that the profits of anthracite companies have been increasing is furnished by the increase in their surplus accounts. In the following table are given the earned surpluses of the railroad coal companies as distinct from surplus arising through revaluation of assets.

The first column of the table shows the surplus of the six railroad coal companies that have been paying dividends in recent years and that are engaged exclusively in the mining and selling of coal. The surplus of these six companies rose from $9,700,000 in 1912 to $53,000,000 in 1919. In other words, it increased more than fivefold in seven years. In 1920 it decreased slightly, chiefly because of the payment by the Lehigh Valley out of its surplus of a dividend of 134 per cent. In 1921 the combined surplus fell to $37,000,000, chiefly because of the payment out of surplus of another dividend of 227 per cent, this time by the Lehigh & Wilkes-Barre. Other large dividends were paid during the year, notably

[1] Extra dividend to enable stockholders to purchase stock of the newly organized Delaware, Lackawanna & Western Coal Co.

[2] Including 35 per cent in securities of the Lackawanna Railroad Co. of New Jersey.

$2,050,000 by the Hillside, equivalent to 205 per cent on its small capital stock, and $6,850,000 by the Pennsylvania Coal Co., on its capital of $5,000,000.

A further drop in the surplus of these companies occurred in 1922, principally because of the strike, partly because the Pennsylvania and Hillside again paid dividends out of surplus amounting to 168 per cent and 190 per cent, respectively. Yet even after the losses of a five-months' strike and the distribution of these considerable sums in dividends the surplus of the companies stood at $27,000,000 at the close of 1922, or not quite three times what it was at the beginning of the period.

Increase in accumulated surplus of the railroad coal companies (exclusive of revaluations of assets)

Year	Six coal companies paying dividends	Lehigh Coal & Navigation Co.[1]	Companies paying no dividends	
			Philadelphia & Reading [2]	Scranton Coal
1912	[3] $9,688,000	$1,655,000	$1,460,000	[4] $936,000
1913	[3] 13,295,000	1,884,000	2,599,000	[4] 911,000
1914	[3] 17,091,000	2,390,000	3,315,000	[4] 721,000
1915	[3] 24,522,000	2,770,000	3,375,000	[4] 730,000
1916	[3] 30,028,000	3,452,000	6,550,000	[4] 537,000
1917	34,527,000	5,238,000	11,986,000	[4] 114,000
1918	39,107,000	5,712,000	16,146,000	[4] 349,000
1919	53,063,000	6,177,000	19,013,000	[4] 44,000
1920	52,094,000	7,434,000	25,685,000	154,000
1921	37,108,000	8,075,000	29,167,000	460,000
1922	27,245,000	7,467,000	29,074,000	[4] 32,000

[1] Includes surplus accumulated out of transportation income.
[2] Company paid little or no interest on advances to it from holding company during this period.
[3] Total of certain companies' reports for fiscal year and others for calendar year.
[4] Deficit.

The Lehigh Coal & Navigation Co., like the other companies, shows a large increase in its earned surplus, rising from $1,655,000 in 1912 to $7,467,000 at the end of 1922.

"The high-cost Scranton Coal Co. paid no dividends during the period, but between 1912 and 1921 the company converted a deficit of $936,000 into a surplus of $460,000. Strike losses during 1922 wiped out the surplus and left the company at the end of the period with a small deficit."

Although paying no dividends and practically no interest on its heavy indebtedness to the Reading Co., the Philadelphia & Reading Coal & Iron Co. increased its net earnings largely during the 10-year period. The surplus account carried the sums of $1,460,000 in 1912 and $29,074,000 at the end of 1922, an increase of $27,614,000.

EXCESSIVE RESERVES OF COAL LANDS

"*Burden of carrying charges of excess reserves of coal land.*—The greater part of the investment of the anthracite operators consists of coal-bearing land. Where, as is the case with a number of companies, lands are held which can not be developed at the present rate of output for some generations to come, the carrying charges become a serious burden. The taxes upon the undeveloped lands are charged to operating costs. The interest is not properly chargeable against cost, but it must come out of the margin. Carrying charges on excessive reserves are one reason why some of the substantial companies pay small dividends or no dividends at all."

Of the companies examined by the United States Coal Commission the following figures represent years the coal owned or leased by the operating interests will last at present annual rates of interest:

Five holdings with life of coal reserves from 100 years to 480 years.
Seven holdings with life of coal reserves from 48 years to 98 years.
Five holdings with life of coal reserves from 27 years to 39 years.
Five holdings with life of coal reserves from 10 years to 21 years.
Three holdings with life of coal reserves from 7 years to 8 years.

"*Philadelphia & Reading Coal & Iron Co.*—The outstanding example of excess reserves of coal-bearing lands is the Philadelphia & Reading Coal & Iron

Co., which owns 85,000 acres of coal lands. According to a semiofficial estimate made some years ago the coal in these lands is sufficient to last for 216 years. The engineering department of the Coal Commission estimates the life of the property at a still higher figure. The taxes on the excess land add to the already high production cost of the Reading and reduce its margin. Freed from this extra tax burden, the margin might be sufficient to pay a modest return if applied to a simple investment in operating properties. Spread over this vast future reserve, the actual margin has paid a very small return.

"The origin of this condition dates back to 1871, when the prosperous Philadelphia & Reading Railroad undertook to buy up all the available coal lands of the middle and southern anthracite regions in order to prevent its rivals, principally the Pennsylvania and the Lehigh Valley Railroads from entering its territory and taking away its traffic. In their haste the officers of the road bought at what were then high prices, a vast speculative reserve of coal lands. They made the purchases through a mining company organized expressly for the purpose and called the Philadelphia & Reading Coal & Iron Co. To finance the enterprise they borrowed about $40,000,000 and advanced it to the mining company. The mining company has since been run as an adjunct to the railroad. Its function has been to provide traffic. Most of the time it has been quite unable to pay the railroad more than nominal interest on the sums advanced to it.

"The coal company owes the holding company, according to the accounts, the sum of $69,000,000. The holding company has carried this by borrowing at 4 per cent on a general mortgage for which the property of the coal company is pledged as part security.

"At first sight it would appear that the Philadelphia & Reading Coal & Iron Co. has been extremely unprofitable. Its production cost has indeed been high, its mines are located in the steeply pitching beds of the western middle field, where costs are high and the southern field, where they are still higher. Other companies in these fields, however, have managed to get along. The peculiar difficulty of the Reading has apparently been to pay the taxes and interest on its enormous reserve of coal lands.

"The thing that saved the Reading Coal & Iron Co. was the absence of effective competition due to the peculiar economic organization of the anthracite industry. A single interest was mining, selling, and transporting the coal. The Philadelphia & Reading Railway was highly profitable, it regularly paid into the treasury of the holding company dividends of 10, 15, and 20 per cent. The adjustment of freight rates and mine prices was such that the railway made large returns while the mining company made little. The profits of the combination must therefore be viewed in the aggregate. The investors received from the railroad operations enough to make up for their losses in coal mining, and to meet the carrying charges on a vast speculative reserve of coal lands and still draw since 1913 regular dividends of 8 per cent on common stock. The stock of the Reading Co. sells around $70 or $80 on a par of $50.

DEPLETION AND DEPRECIATION

"Accounting methods employed by some of the companies with respect to the handling of depletion and depreciation charges and of the resulting reserves for same have changed considerably within the 10-year period. At the beginning of the period some of the companies were not charging depletion or depreciation regularly and therefore carried no reserve accounts on their books. Such depletion and depreciation as was charged at various times was applied directly against the value of the asset itself. In fact, some companies had apparently followed this policy to extreme lengths in earlier years, having written off their books a large percentage of the value of their properties. The case of the Delaware, Lackawanna & Western Railroad (described below in detail in the discussion of the Glen Alden Coal Co. figures) is an example. During the 10-year period values written off in earlier years were apparently restored by many, if not all, of the companies through revaluations, and many millions were added to property accounts in this way. A large part of the revaluations appearing during the 10-year period concerned coal lands. It would be practically impossible to determine in the case of many companies just how much of the additional values added to the coal land accounts represented restoration of values written off through excessive depletion in prior years and how much represented the capitalizing of the enhancement of value ('unearned increment') in coal lands.

"Since depletion and depreciation are charged for the purpose of taking into account the using up of the investmens (to that when the coal is all mined the total amount of investment will all have been retired or 'amortized'), the whole subject is bound up with that of the determination of the investment."

Just what values have been used in determining depletion and depreciation charges is not disclosed in the coal commission report. From Exhibit F, however, it is evident that revaluations of assets were made by the "railroad" coal companies prior to 1913 in the amount of $26,170,000. That during the period 1913 to 1921 revaluations were made in the amount of $184,317,864. It is probable that the latter addition to the book values existing in 1913 represent the additions through revaluations as of March 1, 1913, upon which depletion and depreciation rates would be based. No data was available from the Income Tax Unit to establish such rates.

Exhibit C discloses depletion and depreciation rates for most of the "railroad" and "independent" coal companies, from which averages have been computed both in terms of "cents per ton" of production and in "per cent of net income." These rates are set off in Exhibit H and compared with such rates as have been computed from the very incomplete data obtained from the Income Tax Bureau (Exhibits D and E).

These rates summarized for the postwar period 1919 to 1922, inclusive, are as follows:

Depletion:	Cents per ton
Lehigh Coal & Navigation Co	7.53
Philadelphia & Reading Coal Co	7.69
Lehigh & Wilkes-Barre Coal Co	13.82
Lehigh Valley Coal Co	14.76
Scranton Coal Co	19.81
Delaware, Lackawanna & Western Co	23.56
Pennsylvania Coal Co	No data.
Hudson Coal Co	No data.

Depreciation:	Cents per ton
Scranton Coal Co	4.43
Philadelphia & Reading Co	4.82
Pennsylvania Coal Co	10.15
Delaware, Lackawanna & Western Co	11.13
Lehigh Valley Coal Co	13.01
Lehigh & Wilkes-Barre Coal Co	14.64
Lehigh Coal & Navigation Co	20.95
Hudson Coal Co	No data.

General averages in cents per ton, 1919 to 1922, inclusive

	Depletion			Coal commission	
	Coal commission	Coal valuation section	Audit division	Depreciation	Depletion and depreciation
Railroad coal companies	13.37			11.05	24.6
Independent coal companies	19.61			13.02	32.6
All companies	14.57	17.5	18.6	11.38	26.1
Per cent of net income:					
Railroad coal companies	22.21			16.66	40.84
Independent coal companies	78.10			51.83	29.92
All companies	27.28			19.16	48.91

A really remarkable check has been obtained in depletion and depreciation rates for all companies, with the rates as obtained by the engineers' advisory valuation committee of the United States Coal Commission. In this report it will be noted as follows:

	Committee rates	Averages above
	Cents	*Cents*
Average depletion per ton	14.7	14.57
Average depreciation per ton	10.8	11.38

FEDERAL TAXES

"It was found by the commission's field accountants that the amount of Federal taxes standing on the books of eight railroad coal companies for the period 1917 to 1921 was equivalent to 9.2 cents per ton on total production, including culm-bank washery coal. The amount of the tax per ton varied, of course, with the profits of the company, ranging from 2.2 cents for the lowest to 27.7 cents for the highest of the eight companies. Satisfactory statements were not obtained for the taxes of two other railroad companies (the Delaware, Lackawanna & Western coal department and the Hudson Coal Co.). Had these been included the average tax would have been higher, perhaps as high as 11 cents per ton."

From information obtained from the Income Tax Bureau for four railway coal companies (Exhibit D), the total taxes paid from 1917 to 1920, inclusive, amounted to 18.7 cents per ton of coal produced, or 14.3 per cent of taxable income.

THE GLEN ALDEN COAL CO.

"Since the coal-mining properties of the Delaware, Lackawanna & Western Railroad Co. were treated by that company merely as a department of its total operations, the assets and liabilities of the mining department were merged with those of the railroad organization and included in its report. It has been difficult therefore to determine just what proportion of the corporation's property assets were applicable solely to its coal-mining properties.

"In July, 1918, a detailed statement prepared by vice president and chief counsel of the company was submitted to a Federal agency in which the total actual cost of coal lands as of that time was given as $6,532,578.72. When inquiry was made of officials of the present Glen Alden Coal Co., which succeeded to the coal operations of the Delaware, Lackawanna & Western Railroad Co., by the commission's accountants relative to this statement, all knowledge concerning it was disclaimed. In fact, those questioned in the matter were positive that such statement could not have been made. The commission's accountants, however, have carefully examined this statement, which still is in the files of the Federal agency.

From information secured by the commission's accountants it is evident that the amounts originally expended for mining plants and equipment, or for such property acquired in the earlier years of the Delaware, Lackawanna & Western Railroad Co.'s mining operations, had been written off the books through operating costs long before 1900. The policy of the company in operating its coal department was similar to that which it followed in operating the railroad business; a policy likewise followed generally by carriers in the nineties and early years of the present century.

"In connection with its Federal income and excess profits taxes the Delaware, Lackawanna & Western Railroad Co., on or about the year 1921, restored to its investment account the sum of $11,005,576.40 which it claimed had been previously unduly written off. This amount, plus the book figures 'Miscellaneous physical property' shown as of December 31, 1920, to have been $1,841,940.11, makes a total of $12,847,516.51. The tonnage to which the original investment of $11,005,576.40 applied has been variously stated as having been 645,000,000, 649,000,000, and 657,000,000 tons. The tonnage remaining unmined as at December 31, 1920, the date upon which the investment was stated as $12,847,516.51, was about 418,000,000 tons. In other words, only a little more than one-third of the total anthracite tonnage of the Delaware, Lackawanna & Western Railroad Co. had been mined up to that date. If from the claimed investment of $12,847,516.51 depletion amounting to $4,669,429.88 for the tonnage already mined be deducted, as well as the amount of actual book value, of $1,841,940.11 as of December 31, 1920, there remains the sum of $6,336,146.52 as the amount claimed for additional investment in coal mining property. This latter figure closely corresponds to the figure previously referred to as submitted in 1918, to another Governmental agency.

"The Delaware, Lackawanna & Western Railroad also carried on its books a memorandum account styled 'Value of unmined coal.' This account was created as of 1913. For that year it showed a total of $40,903,954.79. As of August 31, 1921 (the date of the sale of the coal properties to the Glen Alden Coal Co.), this memorandum account stood at $99,139,936.65. The commission's accountants could not find out the basis of this value. Inquiries on the subject put to the company officials did not bring forth any enlightening or satisfactory explanation."

"All the mining properties and equipment were sold to the Glen Alden Coal Co. for a 'consideration' of $60,000,000. In connection with this transaction it is interesting to note that the Delaware, Lackawanna & Western Railroad Co. has filed a brief with the Federal income tax department claiming a loss of $39,139,936.65, the difference between $99,139,936.65, the amount of the memorandum account and the sales price to the Glen Alden Coal Co. of $60,000,000.

"On July 25, 1921, the Delaware, Lackawanna & Western Railroad Co. decided to organize and operate a coal mining company. Accordingly they purchased all the capital stock of the Pine Valley Coal Co. for a consideration of about $22,000. This company was evidently selected for purchase because of certain valuable rights permitted it by its charter.

"Immediately upon the purchase of this stock the name of the Pine Valley Coal Co. was changed to Glen Alden Coal Co. and the number of shares of capital stock changed from 420 to 850,000. The new stock, having no par value, was offered for sale at $5 per share, for subscription to the existing stockholders of the Delaware, Lackawanna & Western Railroad. This offer by the Glen Alden Co. represented a valuable 'right' to the railroad stockholders which sold on the stock market at from $25 to $30 a share, while the stock of the Delaware, Lackawanna & Western Railroad ('ex-rights') showed a corresponding decrease.

"At the time of the sale of the mining properties the railroad company showed on its books assets representing coal property in the amount of $6,240,069.17 according to the closing entries made to clear its books. The Glen Alden Coal Co., on the other hand, shows on its books an opening entry for this property of $72,244,933.04.

"In addition to assuming a $60,000,000 purchase-money mortgage, the Glen Alden Coal Co. assumed the following liabilities:

1. Workmen's compensation liability for all accidents prior to Sept. 1, 1921 (estimated)	$814, 872. 98
2. Lessor's liability—Estimated liability on account of any litigation relative to coal operations	11, 400, 000. 00
3. Mary Burtis Muchmore mortgage	24, 000. 00
4. Deferred royalty payments	6, 060. 06

"The apparent cost, therefore, to the Glen Alden Coal Co. for the railroad company's property was $72,244,933.04."

As outlined in Office Memorandum No. 6, dated December 6, 1924, the coal valuation section recommended on May 2, 1922, a March 1, 1913, value for depletion of $101,754,000 on 460,000,000 tons of recoverable coal and depletion rate of 22.12 cents per ton. Depletion for 1916 and subsequent years has been allowed tentatively on this basis, the taxpayer contending for a rate of 25 cents per ton, with the cases still unsettled in the unit. From the foregoing records of the coal commission as quoted, there would appear to be no justification for any such allowances for depletion and the proposed depletion rates of 22.12 cents per ton is excessive and largely in excess of depletion allowances made the other railroad companies.

DISCUSSION

Income taxes paid by anthracite mines.—The taxes paid by the anthracite companies have heretofore been shown as approximately 11 cents per ton of coal produced; these in terms of net income are for the years 1917 to 1921 as follows:

Percentages (weighted), taxes paid to net incomes

	Railroad companies	Independent companies	Total
	Per cent	*Per cent*	*Per cent*
From coal commission data	13.6	26.4	14.9
From audit division data	14.3	25.7	14.7
Average		26.0	14.8

The coal commission data are based on six and the audit division on four out of a total of eight railroad coal companies. If the taxes paid by the Hudson Coal Co. and Delaware, Lackawanna & Western coal department could be included the percentage for the railroad companies might be increased to approximately 16.8 per cent and for the industry 18 per cent.

On the face of this there is inequity, since the railroad coal companies controlling 85 per cent of the coal output pay proportionately less taxes than the independent companies in the same industry.

A comparison, however, with the bituminous coal industry shows what monopolistic control can accomplish and the great injustices and inequities existing in the payment of income taxes as between the anthracite and bituminous coal operators.

Exhibit I, "Summary and percentages, taxable income and taxes paid, for bituminous coal mines," shows the results of compilations made from records of the special assessment division of the income tax unit. From this it will be noted that for 1918 to 1920, inclusive, the weighted average percentage of taxes paid to net income is 38.26 per cent. Are the income tax laws being justly administered? is best answered by noting these comparisons in taxes paid to net incomes.

	Per cent
For the railroad anthracite coal companies	16. 8
For the independent anthracite coal companies	26. 0
For the bituminous coal companies	38. 26

Possibly some light can be thrown on the reasons for these inequities.

Depletion and depreciation deductions.—Although from Exhibit H it will be noted that the depletion rates reported by the income tax unit exceed that computed from the coal commission data, it would appear conservative to assume that the latter reflect more nearly the correct rates for depletion and depreciation. Since the writer's compilations disclose a weighted average for depletion and depreciation for the years 1919 and 1922 of 25.95 cents per ton as against 25.5 obtained by the engineers' advisory valuation committee, the latter will be used as representing the depletion and depreciation rates reflected by the books of the anthracite industry.

The engineers' advisory valuation committee estimate the recoverable reserves of anthracite coal for 40 years at 3,907,900,000 gross tons. The apparent depletion and depreciation rates reflected by the books of the companies will, when transferred into deductions, result in values being returned to the industry during the 40-year period, as follows:

3,907,900,000 tons at 14.7 cents equal	$574, 461, 300	through depletion.
3,907,900,000 tons at 10.8 cents equal	$422, 053, 200	through depreciation.
Ultimate returns of value at end of 40-year period	966, 514, 500	

The engineers' advisory valuation committee valued these coal reserves as of 1921 at $843,500,000, this value including all appreciations.

Six hundred million dollars was given as the book value of the industry as of 1921. Unfortunately we have no data as to the March 1, 1913, value of the industry upon which depletion rates were supposedly determined, but since the book value as of 1921 includes all March 1, 1913, values, it is evident that the March 1, 1913, value could not be in excess of the 1921 figure. Assuming then a March 1, 1913, value of $600,000,000 for the industry, we find the ultimate return of value computed above is largely in excess of same and that, therefore, the depletion and depreciation rates are excessive for the industry.

Excess ultimate return of value through depletion and depreciation

	Excess over 1921 value	Excess over 1913 value
Ultimate return of value	$996, 514, 500	$996, 514, 500
Basic date values	843, 500, 000	600, 000, 000
Excess value	153, 014, 500	396, 514, 500

The coal commission in their analysis of assets report the coal lands of the railroad companies with data available as representing 65.6 per cent of total assets and plants 27.4 per cent; of the independent companies 43.2 and 58.2, which for the industry would be 60 per cent for coal and 35 per cent for plants. For a total of 100 per cent these percentages would be 63.16 and 36.84 per cent.

Assuming these percentages, then the March 1, 1913, values for coal reserves and capital items are as follows:

March 1, 1913, values:

$600,000,000×63.16 per cent equals	$378,960,000 for coal only.
$600,000,000×36.84 per cent equals	221,040,000 for capital items.
	600,000,000

Corrected depletion and depreciation rates:

$$\frac{378,960,000}{3,907,900,000}=9.7 \text{ cents per ton depletion.}$$

$$\frac{221,040,000}{3,907,900,000}=5.7 \text{ cents per ton depreciation.}$$

Excessive deductions from gross income as indicated by the apparent excessive rates allowed can mean but one thing—largely reduced net incomes upon which taxes are computed and loss of taxable income.

Excessive accumulated surplus accounts.—The effect of the large increases in surplus by the railroad companies during the years 1917 to 1920, inclusive, is quite apparent, since invested capital was increased thereby. Under the excess and war profits acts, these companies saved millions in taxes by these large increases. That such was their purpose is shown by the fact that as soon as the high tax years were past large distributions of surplus were made as extra dividends, as evidenced by the following:

1920. Lehigh Valley paid dividend out of surplus of 134 per cent.
1921. Lehigh & Wilkes-Barre paid dividend out of surplus of 227 per cent.
1921. Hillside Coal Co. paid dividend out of surplus of 205 per cent.
1921. Pennsylvania Coal Co. paid dividend out of surplus of 137 per cent.
1922. Pennsylvania Coal Co. paid dividend out of surplus of 168 per cent.
1922. Hillside Coal Co. paid dividend out of surplus of 190 per cent.

The further effect of these accumulations of corporate profits in high tax years and distribution in low tax years was to reduce somewhat the taxes paid thereon by the stockholders.

Excessive reserves of coal lands.—Carrying charges such as interest and taxes on excess reserves of coal lands results in largely increased costs and correspondingly decreased taxable income. Such carrying charges on reserves in excess of 40 years should not be allowed as deductions from gross income. These excess reserves are a speculation which should not be involved in the determinations of taxes for operating companies.

Accounting methods.—A careful reading of the reports of the United States Coal Commission and the Federal Trade Commission will impress one with the difficulties besetting any Government agency seeking information regarding the anthracite-coal industry. Much of this is due to the lack of uniformity in methods of accounting.

QUOTED FROM THE UNITED STATES COAL COMMISSION REPORT

"The wide differences in accounting methods followed by the operators make the collection of adequate figures of cost, investment, income, and profits a matter of great difficulty. It places excessive burdens on both the operators and the agency that collects and compiles the information. The unavoidable delay in getting and making it available for use is often very costly to the public interest where such information is needed to avert a crisis. Many of these difficulties and delays would be avoided if the Federal Government or the State of Pennsylvania should establish a prescribed system of accounting, compulsory on all operators in the industry. Such a system should be carefully designed to secure sufficient and comparable information, while being at the same time flexible enough to take care of the widely different conditions of the various operators. The establishment of prescribed systems of accounting is not a new departure in governmental activities. For years past railroads, pipe lines, and express companies have been obliged to keep their books in accordance with accounting methods prescribed by the Interstate Commerce Commission. Banks subject to the Federal banking laws have had to follow prescribed accounting methods. There are also State and municipal regulations prescribing the form of accounting to be followed by various public utilities, banks, insurance companies, and other forms of business closely connected with the public interest. If adequate information on income, costs, investment, profits, etc., is to be collected regularly from anthracite operators by any governmental agency, it will first be necessary to establish an adequate system of accounting."

Specific recommendation was made by the commission as follows:

"To protect the public against unjustified increases in price we recommend complete publicity of accounts through a Federal agency with power to compel reports and to prescribe the form of accounts."

QUOTED FROM THE FEDERAL TRADE COMMISSION REPORT

"The greatest obstacle to intelligent action on the part of the Government in handling the frequently recurring emergencies in the coal trade is the lack of adequate current information, particularly regarding prices, cost of production, and profits. The commission believes, therefore, if the matter is found within the legislative power of Congress that some Federal agency should secure and publish currently data on production, prices, costs, and profits in the coal industry."

It would seem equally important that from an income-tax standpoint the Government should be concerned in securing uniform accounting methods in the anthracite coal industry. The whole income-tax subject is grounded on facts regarding prices, costs, and profits, and unless correct facts are obtainable equitable taxation of the industry can not be secured. The taxation of a monopolistic industry such as this should be studied as a whole and the Income Tax Bureau should be fortified with complete information as to the results obtained in administering the laws. It would appear that such information is not available at the present time.

Requests by your committee for information regarding gross and net income, depletion and depreciation allowances, and taxes paid for these coal companies have brought largely the negative reply, "Consolidated returns." Is it not rather incongruous for the Justice Department of the Government to be making strenuous endeavor to break a monopoly by divorcing railroad and mine in the interests of the public, while the taxation department, after supposedly obtaining individual facts necessary to fix equitable taxation then scrambles the facts with those of the railroads and fosters the monopoly.

ADMINISTRATIVE FEATURES

Depletion.—Responsibility for the determination of values for depletion of national resources and of annual deductions for depletion within the income-tax unit would appear by office orders to rest on the various valuation sections of the engineering division.

That the determination of values and depletion for the anthracite properties and industry is quite some responsibility is set forth in the foregoing pages. Is it any wonder that this industry, with its vast resources and complexities, has been able to becloud issues and obtain preferential treatment? In the coal valuation section there are 17 engineers employed on valuation of bituminous coal as against one employed upon anthracite. To my mind the coal valuation section is distinctly undermanned in the handling of anthracite and fails to get at the root of the subject. Much research and statistical work should be carried on by experts and cooperation had with other branches of the Government.

Considering the duties prescribed, it is natural to suppose that the amounts reported by the coal valuation section as allowable annual deductions for the anthracite companies would check with the amounts reported by the audit division as actually deducted in determining net taxable income for these companies. Referring to Exhibit D, it will be noted that in no instances of the few cases comparable do these amounts agree, and the differences are quite considerable as noted below.

	Depletion reported as allowed by—	
	Coal valuation section	Audit division
Lehigh & Wilkes-Barre Coal Co.:		
Second period	$1,011,165	$662,740
Third period	908,373	692,606
Lehigh Coal & Navigation Co.:		
Second period	546,303	535,167
Third period	485,764	435,162
Hudson Coal Co., second period	1,606,513	1,368,515
Total	4,648,118	3,694,190

To the writer the above condition means one of two things—either the bureau reports are in error and not to be depended upon, or the audit and engineering division are not coordinated in the carrying out of office orders, since such records as we have show that depletion reported by the coal valuation section as allowable is not in practice actually allowed as a deduction by the audit division.

Depreciation.—From the foregoing it must be evident that the determination of depreciation allowances is distinctly an engineering problem, since it involves the return of values best established by competent engineers. The engineer first determines the total value of a natural resource. This value then must be segregated into the value of the resource only and the required capital items, such as plant, developments, etc. The first involves depletion, the second depreciation. The office orders of the Income Tax Unit prescribe the determination of depletion to the engineering division, but depreciation is determined by the audit division. This is bad procedure, since the subject, as pertains to natural resources, should be developed to conclusion along with depletion. The duties and the responsibilities should be enlarged to include the determination of values for depreciation and annual depreciation allowances.

CONCLUSION

Mention is made herewith of certain outstanding lessons that may be drawn from this study of the anthracite industry, with suggestions for possible changes in the acts and regulations and the administration of same.

Excessive depletion and depreciation.—An investigation to be made to determine the causes of excessive depletion and depreciation in the anthracite properties, with possible revaluation of the properties as to March 1, 1913, value and invested capital; a limitation, by act or regulation, to be made of 40 years for coal reserves (40 years at normal production) to be included in such depletable and depreciable March 1, 1913, values, and provision made against the allowance of deductions from gross income for depletion and depreciation of speculative reserves in excess of such 40 year reserves.

Depreciation an engineering problem.—Office orders within the Income Tax Unit to be so changed that the determination of values for depreciation and annual depreciation allowances, in connection with natural resource industries, shall be transferred from the audit to the engineering division.

Disallowance of carrying charges on speculative reserves.—That the act or regulations provide against the allowance of carrying charges, such as taxes and interest on speculative reserves, as costs deductable from gross income.

Excessive surplus accounts.—That the act provide against charging into surplus of distributable profits in high tax years for the purpose of increasing invested capital and reducing taxes thereby; that any such profits later distributed shall constitute a basis for reopening and redetermining the taxes affected in the transaction.

Loss on sale of assets.—That a provision be made in the act preventing the allowance of losses on sale of assets when the value of such assets at basic date is determined by any other method than cost.

Consolidated returns.—That an investigation be made into the propriety of allowing returns to be consolidated; if required in the administration of the income tax law, then that some provision be made so that the various corporate indentities, tax liabilities, and construction of such liabilities be kept a matter of record in the Income Tax Unit.

Changes in administrative provisions.—That provisions be made in the Income Tax Unit limiting the individual responsibility of valuation engineers in the determination of values and rates of depletion and depreciation, through cooperation with a final determining board made up of legal, engineering, and auditing experts; that provision be made in the coal valuation section for more comprehensive handling of coal valuations, including research and statistical studies of the coal industry and cooperation with other Government agencies; that provision be made within the Income Tax Unit for coordination of the work of the engineering and auditing divisions.

Respectfully submitted.

EDWARD T. WRIGHT,
Investigating Engineer.

Approved:

L. H. PARKER, *Chief Engineer.*

EXHIBIT C

Data taken from reports of United States Coal Commission, dated September 22, 1923

Period.	Name of company	Average annual production, gross tons	Average capital stock	Average total assets	Dividends paid: Average annual	Dividends paid: Per ton [1]	Dividends paid: Per cent to net income adjusted [1]	Average annual net income: As per books adjusted	Average annual net income: Adjdusted for coal operations
	Railway coal companies								
	1. Pennsylvania and Hillside Coal Cos.:								
1	4½ years, 1912-1916	6,972,405	$8,000,000	$17,264,080	$1,050,000	$0.1506	29.88	$3,513,763	$3,556,426
2	2 years, 1917-18	7,408,386	6,000,000	22,833,982	5,575,000	.7525	74.32	7,501,540	7,301,232
3	4 years, 1919-1922	5,686,603	8,000,000	25,514,748	6,587,500	1.1584	115.21	5,717,766	5,334,815
	Average total per cent					.6584	78.96		
	2. Lehigh Valley and Cox Bros. Coal Cos.:								
1	4½ years, 1912-1916	8,220,763	4,875,150	34,759,047	417,431	.0508	24.66	1,693,082	2,497,967
2	2 years, 1917-18	9,204,581	12,375,150	38,228,208	2,717,212	.2952	86.41	3,144,728	3,614,389
3	4 years, 1919-1922	7,116,791	12,375.150	59,367,996	7,061,956	.9923	153.04	4,614,573	4,829,612
	Average total per cent					.4155	107.87		
	3. Philadelphia & Reading Coal Co.:								
1	4½ years, 1912-1916	9,499,553	8,000,000	88,670,953	None.	None.	None.	1,425,093	1,903,791
2	2 years, 1917-18	11,544,983	8,000,000	100,383,620	None.	None.	None.	5,759,333	5,599,177
3	4 years, 1919-1922	9,383,172	8,000,000	111,568,595	None	None.	None.	3,536,864	3,070,276
	4. Scranton Coal Co.:								
1	4 years, 1913-1916	1,730,374	260,000	7,299,582	None.	None.	None.	136,736	363,966
2	2 years, 1917-18	1,417,469	260,000	5,256,431	None.	None.	None.	153,082	306,114
3	4 years, 1919-1922	1,131,623	260,000	5,043,602	None.	None.	None.	77,902	225,078
	5. Lehigh & Wilkes-Barre Coal Co.:								
1	4 years, 1913-1916	4,845,477	9,210,000	40,786,285	1,197,300	[illegible]	39.97	2,995,388	3,413.295
2	2 years, 1917-18	4,447,314	9,210,000	41,954,649	1,197,300	.2692	27.87	4,295,823	4,500,179
3	4 years, 1919-1922	3,990,496	9,210,000	44,445,491	6,347,463	1.5906	99.62	6,371,604	6,348,677
	Average total per cent					.6582	63.98		

	6. Lehigh Coal & Navigation Co.:								
1	4 years, 1913-1916	3,702,998	26,557,950	58,375,794	2,124,636	.5738	79.36	2,677,07[illegible]	516,241
2	2 years, 1917-18	5,323,231	28,955,260	77,029,680	2,229,154	.4158	57.74	3,860,8[illegible]	1,672,384
3	4 years, 1919-1922	4,258,487	29,208,675	77,665,555	2,336,347	.5489	72.96	3,[illegible],210	793,902
	Average total per cent					.5037	68.69		
	7. Hudson Coal Co.:								
1	4 years, 1913-1916	7,464,599	5,000,000	31,544,143	618,750	.0829	41.12	1,504,784	1,500,824
2	2 years, 1917-1918	8,851,527	11,098,300	55,491,275	719,723	.0813	22.63	3,179,881	3,179,438
3	4 years, 1919-1922	7,460,238	14,829,525	80,808,895	979,547	.1312	30.83	3,176,810	3,193,062
	Average total per cent					.0975	29.49		
	8. Delaware, Lackawanna & Western Coal Co.:								
1	[2]	[2]	[2]	[2]	[2]			[2]	[2]
2	[2]	[2]	[2]	[2]	[2]			[2]	[2]
3	16 months, 1921-22	5,793,526	4,225,075	79,928,593	1,268,309	.2189	101.20	1,253,250	3,597,827
	Totals for railway companies:								
1	Average for 7 interests	42,436,167	59,903,100	278,699,884	5,408,117	.127	38.73	13,945,918	13,752,310
2	Do	48,197,491	75,896,710	341,177,845	12,438,389	.258	44.59	27,895,276	26,172,913
3	Average for 8 interests	44,818,938	84,108,425	484,343,475	24,581,122	.549	87.94	27,950,979	27,395,249
	Average total per cent					.313	60.79		
	Independent coal companies:								
1	Average for 7 interests, 14 companies	9,991,577	8,400,100	36,403,199	2,175,742	.218	91.77	2,370,828	3,006,350
2	Do	9,732,720	7,148,850	50,784,933	2,170,733	.223	52.49	4,135,245	4,716,408
3	Do	7,557,134	7,771,350	54,314,328	2,343,876	.310	123.50	1,597,869	2,204,188
	Average total per cent					.245	79.61		
	Totals for all companies:								
	First period	52,427,744	68,303,200	315,103,083	7,583,859	.145	46.48	16,316,746	16,758,860
	Second period	57,930,211	83,045,560	391,962,778	14,609,122	.252	45.61	32,030,521	30,889,319
	Third period	52,376,070	91,879,775	538,657,803	26,924,998	.514	90.20	29,848,848	29,597,437
	Average total per cent					.302	62.81		

Exhibit C—Continued

Data taken from reports of United States Coal Commission, dated September 22, 1923—Continued

Period	Name of company	Average annual depletion	Average annual depreciation	Per cent to net income: Depletion: Per ton [1]	Per cent to net income: Depletion: Adjusted [1]	Per cent to net income: Depreciation: Per ton [1]	Per cent to net income: Depreciation: Adjusted [1]	Depletion and depreciation: Per cent: Per ton [1]	Depletion and depreciation: Per cent: Total adjusted	Depletion and depreciation: Per cent net income, coal operation adjusted [1]
	Railway coal companies									
	1. Pennsylvania and Hillside Coal Cos.:									
1	4½ years, 1912-1916	(2)	$271, 283	(2)	(2)	. 0389	7. 72			
2	2 years, 1917-18	(2)	505, 918	(2)	(2)	. 0683	6. 74			
3	4 years, 1919-1922	(2)	577, 233	(2)	(2)	. 1015	10. 10			
	Average total per cent					. 0675	8. 10			
	2. Lehigh Valley and Cox Bros. Coal Cos.:									
1	4½ years, 1912-1916	$285, 400	673, 670	. 0347	16. 86	. 0820	39. 79	. 1167	56. 65	
2	2 years, 1917-18	701, 040	795, 480	. 0762	22. 29	. 0864	25. 30	. 1626	47. 59	
3	4 years, 1919-1922	1, 050, 695	925, 892	. 1476	22. 77	. 1301	20. 07	. 2777	42. 84	
	Average total per cent			. 0830	21. 55	. 0976	25. 34	. 1806	46. 89	
	3. Philadelphia & Reading Coal Co.:									
1	4½ years, 1912-1916	(2)	504, 036	(2)	(2)	. 0531	35. 37			
2	2 years, 1917-18	741, 765	920, 024	. 0642	12. 88	. 0797	15. 97	. 1439	28. 85	
3	4 years, 1919-1922	721, 413	452, 422	. 0769	20. 40	. 0482	12. 79	. 1251	33. 19	
	Average total per cent					. 0617	17. 50			
	4. Scranton Coal Co.:									
1	4 years, 1913-1916	348, 222	[illegible], 162	. 2012	254. 67	. 0053	6. 70	. 2065	261. 37	
2	2 years, 1917-18	234, 788	36, 647	. 1656	153. 37	. 0259	23. 94	. 1915	177. 31	
3	4 years, 1919-1922	224, 218	50, 107	. 1981	287. 82	. 0443	64. 32	. 2424	352. 14	
	Average total per cent			. 1886	219. 52	. 0224	26. 08	. 2110	245. 60	

	5. Lehigh & Wilkes-Barre Coal Co.:									
1	4 years, 1913–1916	636, 520	485, 795	.1314	21.25	.1003	16.22	.2317	37.47	....
2	2 years, 1917–18	568, 790	399, 803	.1279	13.24	.0899	9.34	.2178	22.55	....
3	4 years, 1919–1922	551, 538	584, 067	.1382	8.66	.1464	9.17	.2846	17.83	....
	Average total per cent	....	....	.1323	12.87	.1106	10.76	.2429	23.63	....
	6. Lehigh Coal & Navigation Co.:									
1	4 years, 1913–1916	165, 810	511, 889	.0448	6.19	.1382	19.12	.1830	25.31	....
2	2 years, 1917–18	521, 291	1, 097, 238	.0979	13.50	.2061	28.42	.3040	41.92	....
3	4 years, 1919–1922	320, 459	891, 854	.0753	10.01	.2095	27.85	.2848	37.86	....
	Average total per cent	....	....	.0759	10.34	.1884	25.68	.2643	36.02	....
	7. Hudson Coal Co.:									
1	4 years, 1913–1916	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	....
2	2 years, 1917–18	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	....
3	4 years, 1919–1922	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	....
	8. Delaware, Lackawanna & Western Coal Co.:									
1	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	....
2	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	....
3	16 months, 1921–22	1, 364, 863	644, 741	.2356	108.91	.1113	51.45	.3469	160.36	....
	Totals for railway companies:									
1	Average for 7 interests	1, 435, 952	2, 455, 835	.0776	19.14	[illegible]	19.74	.169	41.54	45.89
2	Do	4, 716, 406	3, 755, 110	.0867	16.08	.0954	15.19	.188	34.95	38.34
3	Average for 8 interests	4, 233, 186	4, 126, 319	.1337	22.21	.1105	16.66	.246	40.84	41.25
	Average total per cent	....	....	.1028	19.27	.0926	16.69	.206	38.64	40.91
	Independent coal companies:									
1	Average for 7 interests, 14 companies	346, 735	144, 741	.0598	14.23	.0250	5.94	.085	20.17	18.77
2	Do	1, 316, 110	778, 611	.1352	31.83	.1376	20.68	.241	36.18	35.27
3	Do	1, 482, 186	983, 661	.1961	78.10	.1302	51.83	.326	129.92	111.87
	Average total per cent	....	....	.1362	37.13	.1003	23.55	.227	53.33	49.73
	Totals for all companies:									
	First period	1, 782, 687	2, 600, 576	.0734	17.94	.0638	17.48	.149	36.30	38.34
	Second period	4, 083, 784	4, 533, 721	.0980	19.13	.1007	15.92	.196	35.17	37.74
	Third period	5, 715, 372	5, 109, 980	.1457	27.28	.1138	19.16	.261	48.91	48.64
	Average total per cent	....	....	.1109	22.17	.0938	17.48	.210	40.94	42.44

[1] Per ton figures and percentages obtained when necessary after proper eliminations and corrections.
[2] No data.

Exhibit D.—*Data taken from reports from coal valuation section and audit division, income tax unit*

Periods	Name of company	Average annual production, gross tons	Gross income		Net taxable income	Coal valuation depletion		Audit division depletion deducted				Total tax		
			Amount	Per ton produced		Allowable	Per ton	Amount	Per ton	Per cent to gross income	Per cent to taxable income	Assessed	Per cent to taxable income	Per cent to tons produced
	"Railroad" Coal Companies													
	1. Pennsylvania & Hillside Coal Cos.:													
2	2 years, 1917-18	7,518,081	(1)	(1)	(1)	1,879,432	25.0	(2)	(2)					
3	1 year, 1919	6,975,875	(1)	(1)	(1)	1,640,728	23.5	(2)	(2)					
	Average per cent						24.3							
	2. Lehigh Valley & Coxe Bros. Coal Cos.:													
2	2 years, 1917-18	5,858,792	(1)	(1)	(1)	1,139,845	19.5	(2)	(2)					
3	2 years, 1919-20	6,173,130	(1)	(1)	(1)	1,125,111	18.2	(2)	(2)					
	Average per cent						18.8							
	3. Philadelphia & Reading Coal Co.:													
2	2 years, 1917-18	10,061,477	(1)	(1)	(1)	1,291,506	12.8	(2)	(2)					
3	1 year, 1919	8,804,806	(1)	(1)	(1)	1,217,693	13.8	(2)	(2)					
	Average per cent						13.3							
	4. Scranton Coal Co.:													
2	2 years, 1917-18	500,745	(1)	(1)	(1)	94,781	18.9	(2)	(2)					
3	2 years, 1919-20	583,672	(1)	(1)	(1)	110,478	18.9	(2)	(2)					
	Average per cent						18.9							
	5. Lehigh & Wilkesbarre Coal Co.:													
2	2 years, 1917-18	4,325,388	15,407,520	3.56	4,353,608	1,011,165	23.4	662,740	15.3	4.30	15.2	870,471	20.0	20.1
3	2 years, 1919-20	3,895,492	14,109,773	3.62	6,363,495	998,373	25.6	692,606	17.8	4.91	10.9	1,[illegible]19,825	19.2	31.3
	Average per cent			3.59			24.4		16.5	4.59	12.6		19.5	25.4

	6. Lehigh Coal & Navigation Co.:													
2	2 years, 1917-18	3,572,454	18,019,455	5.04	4,092,087	546,303	15.3	535,167	15.0	2.97	13.1	495,238	12.1	13.9
3	2 years, 1919-20	3,178,192	18,031,314	5.67	4,786,862	485,764	15.3	435,162	13.7	2.41	9.1	693,254	14.5	21.8
	Average per cent			5.34			15.3		14.4	2.69	10.9		13.4	17.6
	7. Hudson Coal Co.:													
2	1 year, 1917	6,695,365	55,918,777	8.35	3,736,988	1,606,513	24.0	1,368,515	20.4	2.45	36.6	298,209	8.0	4.45
3	1 year, 1919	(1)	(1)		3,754,921	(1)		(1)				281,470	7.5	
	Average per cent												7.7	
	8. Delaware, Lackawanna & Western Ry. Co.:													
2	2 years, 1917-18	8,686,257	56,978,158	6.56	8,995,726	(1)		(2)				1,901,219	21.1	21.9
3	2 years, 1919-20	7,719,236	(1)		15,638,606	(1)		2,061,286	26.7		13.2	1,638,501	10.5	21.2
	Average per cent												14.4	21.6
	Total for "railroad" coal companies:													
2	Average for all companies	47,218,559	146,321,920	6.29	21,178,409	7,569,545	19.6	2,566,422	17.6	2.87	21.1	3,565,137	16.8	15.3
3	Do	37,330,403	32,141,087	4.54	30,543,884	5,578,147	18.8	3,189,054	21.6	3.51	11.9	3,833,050	12.5	24.0
	Average per cent			5.88			19.3		19.6	3.04	14.8		14.3	18.7
	Total for "independent" coal companies:													
2	Average for all companies	4,513,840	14,160,248	3.26	1,241,778	423,197	9.38	473,936	10.9	3.35	38.2	238,703	19.2	5.3
3	Do	4,764,770	10,699,958	2.31	421,948	446,291	9.37	420,817	9.1	3.93	99.7	188,308	44.6	4.0
	Average per cent			2.77			9.37		10.0	3.60	53.8		25.7	4.6
	Total for all coal companies:													
2	Total, average and percentage	51,732,399	160,482,168	5.81	22,420,187	7,992,742	18.6	3,040,358	16.1	3.25	18.4	3,803,840	17.0	13.7
3	Do	42,095,173	42,841,045	3.66	30,965,832	6,024,438	17.5	3,609,871	18.6	3.61	13.3	4,021,358	13.0	19.1
	Average per cent			5.17			18.1		17.3	3.36	15.2		14.7	15.9

[1] No data.

[2] Consolidated return.

EXHIBIT E.—*Data taken from special-assessment records of the Income Tax Bureau*

Reference No.	Name of company	Town	Gross income	Depreciation	Depletion	Net incomes: Operating	Net incomes: Operating without depletion	Net incomes: Taxable	Total taxes paid	Per cent depletion to net income: Operating without depletion	Per cent depletion to net income: Operating	Per cent depletion and depreciation to income: Gross income	Per cent depletion and depreciation to income: Net operating	Per cent depletion and depreciation to income: Net taxable	Per cent taxes to taxable income
58	"Railroad" coal companies: Lehigh & Wilkes-Barre Coal Co. (period 2, 1 year, 1918).	Wilkes-Barre	$20,916,610	$477,787	$771,137	$5,533,019	$5,055,232	$4,284,096	$963,685	15.25	13.94	5.97	22.57	29.15	22.49
	"Independent" coal companies:														
	1918														
33	G. B. Markle Co.	Jeddo	7,984,965	246,863	1,099,427	3,805,400	3,558,537	2,454,111	1,449,864						
53	Buck Run Coal Co.	Minersville	1,078,429	26,852	5,644	82,631	55,779	50,135	23,852						
8	Haddock Mining Co.	Wilkes-Barre	828,829	32,115	28,085	101,654	69,539	41,454	20,541						
45	Northern Anthracite Coal Co.	Lopez	743,479	41,832	10,639	258,759	216,927	206,288	135,949						
57	Upper Lehigh Coal Co.	Philadelphia	707,940	30,466	22,672	176,725	146,259	123,587	20,452						
38	Green Ridge Coal Co.	Scranton	342,204	5,914	10,450	39,955	34,041	23,590	6,072						
70	Spencer Coal Co.	Dunsmore	246,086	21,806	13,728	101,653	79,847	40,830	20,679						
42	Highland Coal Co.	Johnstown	70,858	510	1,282	23,060	22,550	21,268	7,693						
	Total and percentage		12,002,790	406,358	1,191,927	4,589,831	4,183,479	2,961,263	1,6[illegible]4,102	28.49	25.97	13.32	34.82	53.97	57.21
	1919														
74	Temple Coal Co.	Scranton	6,256,782	263,285	104,095	885,880	781,785	502,502	67,630						
19	Connell Anthracite Mining Co.	do	1,359,083	16,536	9,508	294,929	278,393	198,038	3[illegible],376						
38	Plymouth Coal Mining Co	Philadelphia	145,543	3,326	499	25,097	21,771	21,271	5,273						
54	Highland Coal Co.	Johnstown	35,006	813	589	7,151	6,338	5,249	506						
	Total and percentage		7,796,416	283,960	114,691	1,213,057	1,088,287	727,060	112,785	10.54	9.53	5.11	32.86	54.83	15.51
	1920														
26	Temple Coal Co.	Scranton	8,038,792	265,818	110,530	1,664,762	1,398,944	1,211,225	308,986						
59	Kingston Coal Co.	Kingston	5,503,028	134,213	36,718	1,100,690	966,477	929,758	216,023						
6	East Bear Ridge Colliery Co.	Scranton	1,500,016	45,138	84,302	380,301	335,163	242,629	87,652						
5	Connell Anthracite Coal Co.	do	1,097,268	18,257	9,440	238,831	220,574	206,134	41,562						

69	Haddock Mining Co.	Wilkes-Barre	1,060,247	71,223	22,197	235,007	163,784	141,582	51,594						
25	East Pittston Coal Co.	Scranton	248,315	14,389	45,913	129,132	114,743	68,829	24,682						
	Total and percentage		17,467,666	549,038	309,100	3,748,723	3,119,685	2,800,157	730,499	9.91	8.25	4.91	22.89	30.65	26.09
	Totals for 1919 and 1920		25,264,082	832,998	423,791	4,961,780	4,207,972	3,527,217	843,284	10.07	8.54	4.97	25.33	35.63	23.91
	Totals for "independent" coal companies:														
2	Period, 1 year, 1918		12,002,790	406,358	1,191,927	4,589,831	4,183,479	2,961,263	1,694,102	28.49	25.97	13.32	34.82	53.97	57.21
3	Period, 2 years, 1919-20		25,264,082	832,998	423,791	4,961,780	4,207,972	3,527,217	843,284	10.07	8.54	4.97	25.33	35.63	23.91
	Grand total		37,266,872	1,239,356	1,615,718	9,551,611	8,391,451	6,488,480	2,537,386	19.25	16.92	7.66	29.89	44.00	39.11

EXHIBIT F.—*Summary of values of "railroad" coal properties, from United States Coal Commission report, year 1921*

Name of interest	Total assets	Investment in coal operations	Net income from coal operations	Per cent return on investment in coal operations	Revaluations prior to 1921	Apparent costs of properties	Per cent return on costs of properties
1. Pennsylvania & Hillside Cos.	$66,367,000	$53,026,000	$5,950,000	11.2	$40,000,000	$13,026,000	45.7
2. Lehigh Valley & Coxe Bros.	80,656,000	46,301,000	5,831,000	12.6	42,050,000	4,251,000	137.2
3. Philadelphia & Reading	114,862,000	97,198,000	4,119,000	4.2	7,012,000	90,186,000	4.7
4. Scranton Coal Co.	5,079,000	4,126,000	465,000	11.3		4,126,000	11.3
5. Lehigh & Wilkes-Barre	39,266,000	28,974,000	8,707,000	30.0	6,169,000	22,805,000	38.2
6. Lehigh Coal & Navigation Co.	77,151,000	31,966,000	678,000	2.1	16,214,000	15,752,000	4.3
7. Hudson Coal Co.	85,326,000	51,298,000	4,496,000	8.8	33,038,000	18,260,000	24.6
8. Delaware, Lackawanna & Western	79,478,654	72,244,933	4,002,732	5.5	66,004,864	6,240,069	64.1
Total	548,185,654	385,133,933	34,248,732	8.9	210,487,864	174,646,069	19.6

Appreciation in values prior to 1913	$26,170,000
Appreciation in values 1913 to 1921	184,317,864
Total	210,487,864

[1] $40,000,000 appreciation carried in memorandum form, not on books.
[2] Net income given for one-third of year only, annual income estimated.

EXHIBIT G.—*Summary of dividend-paid percentages for anthracite companies, prepared from Exhibit C*

	Pre-war period, 1913-1916, inclusive			War period, 1917-18, inclusive			Postwar period, 1919-1922, inclusive			Ten-year period, 1913-1922, inclusive		
	Cents per ton	Per cent to capital stock	Per cent to net income	Cents per ton	Per cent to capital stock	Per cent to net income	Cents per ton	Per cent to capital stock	Per cent to net income	Cents per ton	Per cent to capital stock	Per cent to net income
Pennsylvania & Hillside Coal Cos.	.1506	17.50	29.88	.7525	92.92	74.32	1.1584	109.79	115.21	.6584	73.40	78.96
Lehigh Valley & Coxe Bros. Cos.	.0508	8.56	24.66	.2952	21.96	86.41	.9923	57.07	153.04	.4155	34.42	107.87
Philadelphia & Reading Co.	None.	None.	None.	None.	None.	None.	None.	None.	None.	None.	None.	None.
Scranton Coal Co.	None.	None.	None.	None.	None.	None.	None.	None.	None.	None.	None.	None.
Lehigh & Wilkes-Barre Co.	.2471	13.00	39.97	.2092	13.00	27.87	1.5906	68.92	99.62	.6582	31.64	63.98
Lehigh Coal & Navigation Co.	.5738	8.00	79.38	.4188	7.70	57.74	.5489	8.00	72.96	.5067	7.90	68.69
Hudson Coal Co.	.0829	12.38	41.12	.0813	6.49	22.63	.1312	6.61	30.83	.0975	7.50	29.49
Delaware, Lackawanna & Western	(1)	(1)	(1)	(1)	(1)	(1)	.2189	30.02	101.20	----	----	----
Total for "railroad" companies	.127	9.03	38.78	.258	16.39	44.59	.549	29.23	87.94	.313	19.29	60.79
Total for "independent" companies	.218	25.90	91.77	.223	30.36	52.49	.310	30.16	123.50	.245	28.69	79.61
Grand total	.145	11.10	46.48	.252	17.59	45.61	.514	29.30	90.20	.302	20.19	62.81

[1] No data.

EXHIBIT H.—*Summary of depletion and depreciation deduction percentages for anthracite companies*

	Pre-war period 1913-1916, inclusive (Coal Commission data)		War period 1917-18						Postwar period 1919-1922, inclusive						10-year period 1913-1922, inclusive					
			Cents per ton			Per cent to net income			Cents per ton			Per cent to net income			Cents per ton			Per cent to net income		
	Cents per ton	Per cent to net income	Coal Commission	Coal section	Audit division	Coal Commission	Special assessment	Audit division	Coal Commission	Coal section	Audit division	Coal Commission	Special assessment	Audit division	Coal Commission	Coal section	Audit division	Coal Commission	Special assessment	Audit division
DEPLETION																				
Pennsylvania and Hillside Coal Cos.	----	----	----	25.0	----	----	----	----	----	23.5	----	----	----	----	----	24.3	----	----	----	----
Lehigh Valley and Coxe Bros. Coal Cos.	0.0347	16.86	0.0762	19.5	----	22.29	----	----	0.1476	18.2	----	22.77	----	----	0.0830	18.8	----	21.55	----	----
Philadelphia & Reading Coal Co.	----	----	.0642	12.8	----	12.88	----	----	.0769	13.8	----	20.40	----	----	----	13.3	----	----	----	----

Scranton Coal Co	.2012	254.67	.1656	18.9		153.37			.1981	18.9		287.82			.1886	18.9		219.52		
Lehigh & Wilkes-Barre Coal Co	.1314	21.25	.1279	23.4	15.3	13.24	13.9	15.2	.1382	26.6	17.8	8.66		10.9	.1323	24.4	16.5	12.87		12.6
Lehigh Coal & Navigation Co	.0448	6.19	.0979	15.3	15.0	13.50		13.1	.0753	15.3	13.7	10.01		9.1	.0759	15.3	14.4	10.34		10.9
Hudson Coal Co				24.0	20.4			38.6												
Delaware, Lackawanna & Western									.2356		26.7	108.91		13.2						
Average for "railroad" companies	.0776	19.14	.0867	19.6	17.6	16.08		21.1	.1337	18.8	21.6	22.21		11.9	.1028	19.3	19.6	19.27		14.8
Average for independent companies	.0598	14.23	.1352	9.4	10.9	31.83	25.9	38.2	.1961	9.4	9.1	78.10	8.5	99.7	.1362	9.4	10.0	37.13	16.9	52.8
Average for all companies	.0734	17.94	.0980	18.6	16.1	19.13		18.4	.1457	17.5	18.6	27.28		13.3	.1109	18.1	17.3	22.17		15.2
DEPRECIATION																				
Pennsylvania and Hillside Coal Cos	.0389	7.72	.0683			6.74			.1015			10.10			.0675			8.10		
Lehigh Valley and Coxe Bros. Coal Cos	.0820	39.79	.0864			25.30			.1301			20.07			.0976			25.34		
Philadelphia & Reading Coal Co	.0531	35.37	.0797			15.97			.0482			12.79			.0617			17.50		
Scranton Coal Co	.0053	6.70	.0259			23.94			.0443			64.32			.0224			26.98		
Lehigh Wilkes-Barre Coal Co	.1003	16.22	.0899			9.31			.1464			9.17			.1106			10.76		
Lehigh Coal & Navigation Co	.1382	19.12	.2061			28.42			.2095			27.85			.1884			25.68		
Hudson Coal Co																				
Delaware, Lackawanna & Western									.1113			51.45								
Average for "railroad" companies	.0702	19.74	.0954			15.19			.1105			16.66			.0926			16.69		
Average for independent companies	.0250	5.94	.1376			20.68			.1302			51.83			.1003			23.55		
Average for all companies	.0638	17.48	.1007			15.92			.1138			19.16			.0937			17.48		
DEPLETION AND DEPRECIATION																				
Pennsylvania and Hillside Coal Cos																				
Lehigh Valley and Coxe Bros. Coal Cos	.1167	56.65	.1626			47.59			.2777			42.84			.1806			46.89		
Philadelphia & Reading Coal Co			.1439			28.85			.1251			33.19								
Scranton Coal Co	.2065	261.37	.1915			177.31			.2424			352.14			.2110			245.60		
Lehigh & Wilkes-Barre Coal Co	.2317	37.47	.2178			22.55	22.6		.2846			17.83			.2429			23.63		
Lehigh Coal & Navigation Co	.1830	25.31	.3040			41.92			.2848			37.86			.2643			36.02		
Hudson Coal Co																				
Delaware, Lackawanna & Western									.3469			160.36								
Average for "railroad" companies	.1690	41.54	.1880			34.95			.2460			40.84			.2060			38.64		
Average for independent companies	.0850	20.17	.2410			36.18	34.8		.3280			129.92	25.3		.2270			53.33		
Average for all companies	.1490	36.30	.1960			35.17			.2610			48.91			.2100			40.94		

Summary and percentages, taxable income and taxes paid, bituminous coal mines

	Taxes paid	Taxable income	Number of companies	Per cent tax
1918				
Pennsylvania mines	$7,340,263	$14,632,808	45	50.16
Southern States mines	4,747,758	10,408,395	51	45.61
Central States mines	11,068,801	20,631,661	77	53.65
Total	23,156,822	45,672,864		50.70
1919				
Pennsylvania mines	1,751,033	7,532,102	49	23.25
Southern States mines	1,072,611	4,498,581	39	23.84
Central States mines	1,956,740	8,670,444	62	22.57
Total	4,780,384	20,701,127		23.09
1920				
Pennsylvania mines	4,411,641	14,207,407	45	31.05
Southern States mines	4,229,687	11,446,158	45	36.95
Central States mines	6,254,031	19,921,915	64	31.39
Total	14,895,359	45,575,480		32.68
1918-1920				
Pennsylvania mines	13,502,937	36,372,317	46	37.12
Southern States mines	10,050,056	26,353,134	45	38.14
Central States mines	19,279,572	49,224,020	67	39.17
Total	42,832,565	111,949,471		38.26

SEPTEMBER 29, 1925.

Mr. L. C. Manson, counsel, Senate Committee for Investigation Bureau of Internal Revenue. Office Report No. 46.

Subject: Report on the bituminous coal industry.

INTRODUCTION

As a basis for this report statistical information was requested from the coa valuation section of the engineering division and the audit division, income Tax Unit. Reports have been received on a limited number of companies for taxable years 1917 to 1920, inclusive. This data has been worked up and summarized as Exhibit C. The information is quite unsatisfactory, both as to being representative of the industry and in correctness, there being very apparent discrepancies, particularly in depletion allowances, between the two divisions. As a further check, information was obtained from the special assessment division records on some 150 companies, which has been summarized as Exhibit D. Unfortunately the bituminous coal report of the United States Coal Commission has not yet been published and is not available as a further check on the subject. Reference will be made to the report of the engineer's advisory valuation committee of the United States Coal Commission, on "Valuation of Coal Mining Properties in the United States," published in February, although not accepted for inclusion in the Coal Commission's report.

THE BITUMINOUS COAL INDUSTRY

Bituminous coal, including lignite, occurs in commercial quantities in some 30 States of the Union, although the most important areas are in the industrial States of Pennsylvania, West Virginia, Illinois, Ohio, Kentucky, and Indiana. The industry is distinctly diffused, there being from 10,000 to 11,000 mines. Ordinarily soft-coal mining is a no-profit industry. From 1912 to 1914 the industry was extremely dull; in 1915 under the impetus of war conditions and until the latter part of 1920 it experienced a boom, high prices, and abnormal profits. Since then it has experienced extreme dullness, with production facilities largely in excess of the requirements of normal times.

Soft coal mines can be divided into three classes, according to their economic situations, as follows:

"Captive" mines, subsidiaries and owned by large industries, enjoying steady running time and furnishing a constant supply of low-cost, high-quality coal at little or no profit.

"Railroad" mines, owned by some railroad and with output largely going to the railroad, but not so favorably fixed since the railroad, for business reasons, buy more or less from mines along their right of way. These mines produce low-cost coal at little or no profit to themselves.

"Commercial" mines, in which productivity depends on "marketing ability," although some 8,000 of these are small mines of precarious existence, selling largely through brokers.

FEDERAL TAXES

The industry would appear, from available data, to have contributed generously in Federal taxation, certainly far in excess of the anthracite industry. From Exhibits C and D it will be noted that for the years 1918 to 1920, inclusive, the percentage of taxes paid to net taxable income are as follows:

Per cent taxes paid to net taxable income

	Special assessment data	Audit division data	Average
	Per cent	*Per cent*	*Per cent*
Taxable year 1918	50.70	44.72	47.71
Taxable year 1919	23.09	22.10	22.60
Taxable year 1920	32.68	34.82	33.75
Average	38.26	35.61	36.94

DEPLETION AND DEPRECIATION

There would appear to be very considerable discrepancies in the amounts of annual depletion deductions, reported by the engineering and audit divisions (for identical cases and taxable years) so that it is necessary to strike an average between the two to develop the rate of depletion per ton of coal produced, as follows:

Data from income-tax bureau, years 1918 to 1920, inclusive

	Cents
Depletion allowed, reported by engineering division per net ton	4.47
Depletion deducted, reported by audit division do	6.24
Average do	5.355

From the data obtained from the special assessment division records, the percentages of depletion and depreciation deductions to net operating income have been computed as follows:

Data from special assessment division, years 1918 to 1920, inclusive

	Percentage	Per cent of total
Depletion to net operating income	6.89	37.467
Depreciation to net operating income	11.50	62.533
Total	18.39	100.00

Having obtained, as above, the per cent of total for depletion and depreciation, we can compute the depreciation deducted in terms of cents per ton, by combining the two tables above, as follows:

Depletion and depreciation for bituminous coal mines

	Per cent of total	Per cent of net operating incom	Cents per ton coal produced
Depletion	37.467	6.89	5.355
Depreciation	62.533	11.50	8.938
	100.000	18.39	14.293

CURRENT MARKET VALUE, AS OF 1921

Quoting from report of the engineers' advisory valuation committee—

"In appraising bituminous coal, your committee, in addition to considering recent earnings submitted, has given full consideration to all data available, earnings of earlier years, sales values, royalty rates, and past performances, and present hereinafter estimates of tonnage and value which it believes to be most conservative and fully justified by the data obtained.

"The total tonnage is based on estimates of the United States Geological Survey, and of various State surveys, all revised and reduced to allow for losses in mining and for thin and unavailable coal included in these estimates but not considered as of special value. The total tonnages considered in the committee's estimate are actually materially less than one-half of the tonnage estimated by the United States Geological Survey as remaining at the end of 1920.

"Available coal is estimated as that commercial mineable within 40 years, allowing for probable gradual increases in the rate of output to a total for the whole industry of 1,000,000,000 tons per year at the close of the 40-year period.

"Reserves are considered as such coal as would be available after the exhaustion of the available coal, excluding from any consideration all coal so situated as to be impracticable of access, and all coal so thin or of such depth as to have no present sale value.

"In determining the amount of reserve coal, an effort has been made to confine this item to coal which at the present time, or at least within the 40-year life of the available coal, would have actual ascertainable sale value, and be capable of beneficiation.

"As the values of available coal were obtained by discounting probable earnings, these values necessarily include all plant, development, equipment, mine housing, and other properties directly connected with the business. They do not include outside factors as interest or rentals received, profits from connected undertakings as stores, farms, selling of purchased coal and the like. The values of reserves are those of the coal land only and are, in general, far below the market price of similar lands in the same localities. It is the feeling of your committee that all the coal to be mined within 40 years, whether from present or future operations, is included in available coal and that all reserve values should be treated as deferred."

The committees' estimate of the value of the coal properties of the country, not including coal in Alaska or in the island dependencies of the United States, is as follows. Discount rate used, 8 per cent compound interest:

Appraisal, bituminous coal, including lignite

	Tonnage, net tons	1921 value
40 years' reserves	32,000,000,000	$6,286,214,000
Future reserves beyond 40 years	1,593,150,000,000	5,156,650,000
Total reserves	1,625,150,000,000	11,442,864,000

ULTIMATE VALUE AT INDICATED DEPLETION AND DEPRECIATION RATES

Assuming the 40 years' reserves of bituminous coal, as estimated by the engineers' advisory valuation committee as correct for the life of the industry and using the depletion and depreciation rates indicated, we can obtain a comparison with the committee's valuation, as follows:

Committee's valuation, 40-year life	$6, 286, 214, 000
Ultimate value, 32,000,000 by 14.293 cents	4, 573, 760, 000
Difference	1, 712, 454, 000

CONCLUSION

As "marketing ability" is of such importance in coal and as future prices are difficult to predict the analytical appraisal method of valuation of coal mines does not appear to be proper. As a matter of fact this method is seldom used by the coal-valuation section. Valuations are based upon information gathered pertaining to sales and royalty rates prevailing in the various districts. Because of the diffusion of the industry there are many sales and the comparative sales method of valuation becomes applicable. Royalty rates in a district do not fluctuate violently and reflect the market value of coal in place; discounted to present value according to the life of the property they offer a suitable basis for the valuation of bituminous-coal mines. There would, therefore, appear to be little to criticise in the method of valuation used in the unit. We submit, however, that to obtain correct valuations it is of the utmost importance that research and statistical work be carried on. We believe, also, that the determination of depreciation allowances by the coal-valuation section should be made a matter of office orders, since it is an engineering problem. Attention is also directed to the fact that in bituminous coal, depreciation would appear to involve almost double the values for depletion, the percentages being 37.47 per cent for depletion and 62.53 per cent for depreciation.

Respectfully submitted.

EDWARD T. WRIGHT.

Approved:

L. H. PARKER, *Chief Engineer.*

EXHIBIT C.—*Summary of data obtained from engineering and audit divisions, Income Tax Bureau*

Number of companies reported	District	State	Reported by coal valuation section: Production	Reported by coal valuation section: Depletion	Reported by coal valuation section: Depletion, rate per ton	Reported by audit division: Gross income	Reported by audit division: Net taxable income	Reported by audit division: Depletion	Reported by audit division: Tax assessed	Reported by audit division: Depletion, cents per ton	Per cent depletion to— Gross income	Per cent depletion to— Net income	Per cent tax to net income
	Taxable year 1917:		*Net tons*										
26	Northeastern	Pennsylvania	8, 008, 422	$538, 198	6. 40	$25, 328, 701	$6, 451, 619	$562, 704	$2, 523, 506	7. 03	2. 22	8. 72	39. 11
9	Southern	West Virginia	2, 153, 497	45, 786	2. 10	7, 301, 405	2, 527, 510	43, 791	1, 275, 244	2. 03	. 60	1. 73	50. 45
14	Central	Ohio, Kentucky, Illinois, Missouri.	2, 899, 344	92, 128	3. 18	5, 394, 976	1, 365, 229	58, 599	452, 366	2. 02	1. 09	4. 29	33. 13
49	Total		13, 061, 263	676, 112	5. 18	38, 023, 082	10, 344, 358	665, 094	4, 251, 116	5. 09	1. 75	6. 43	41. 10
	Taxable year 1918:												
25	Northeastern	Pennsylvania	7, 990, 274	505, 120	6. 32	14, 532, 614	3, 686, 645	553, 594	1, 814, 664	6. 93	3. 81	15. 02	49. 22
10	Southern	do	2, 131, 297	78, 591	3. 70	9, 792, 767	2, 758, 056	74, 687	1, 132, 917	3. 50	. 76	2. 71	41. 08
14	Central	do	3, 125, 263	68, 279	2. 18	3, 534, 309	1, 256, 268	103, 455	496, 492	3. 31	2. 93	8. 24	39. 52
49	Total		13, 246, 834	651, 990	4. 92	27, 859, 690	7, 700, 969	731, 736	3, 444, 073	5. 52	2. 63	9. 50	44. 72
	Taxable year 1919:												
25	Northeastern	Pennsylvania	6, 822, 917	370, 854	5. 44	11, 172, 148	1, 624, 421	494, 527	424, 016	7. 25	4. 43	30. 44	26. 10
10	Southern	do	1, 693, 653	58, 123	3. 40	12, 483, 673	2, 023, 461	58, 857	389, 320	3. 48	. 47	2. 91	19. 24
14	Central	do	2, 261, 102	57, 349	2. 54	3, 145, 804	424, 590	57, 110	86, 652	2. 53	1. 82	13. 45	20. 41
49	Total		10, 777, 672	486, 326	4. 51	26, 801, 625	4, 072, 472	610, 494	899, 988	5. 66	2. 28	14. 99	22. 10
	Taxable year 1920:												
24	Northeastern	Pennsylvania	8, 705, 831	398, 869	4. 58	21, 622, 293	9, 465, 490	489, 777	3, 198, 211	5. 63	2. 27	5. 17	33. 79
8	Southern	do	1, 302, 756	44, 101	3. 40	15, 605, 213	8, 332, 854	94, 218	2, 980, 311	7. 23	. 60	1. 18	35. 77
11	Central	do	2, 450, 968	50, 508	2. 06	4, 686, 550	1, 324, 470	349, 289	480, 147	14. 25	7. 45	26. 37	36. 25
43	Total		12, 459, 555	493, 478	3. 96	41, 914, 056	19, 122, 814	933, 284	6, 658, 669	7. 49	2. 23	4. 88	34. 82
	Total for 3-year period, 1918–1920, inclusive:												
74	Northeastern		23, 519, 022	1, 274, 843	5. 42	47, 327, 055	14, 776, 556	1, 537, 898	5, 436, 891	6. 54	3. 25	10. 41	36. 79
28	Southern		5, 127, 706	180, 815	3. 53	37, 881, 653	13, 114, 371	227, 762	4, 502, 548	4. 44	6. 01	1. 74	34. 33
39	Central		7, 837, 333	176, 136	2. 25	11, 366, 663	3, 005, 328	509, 854	1, 063, 291	6. 51	4. 49	16. 97	35. 38
141	Total		36, 484, 061	1, 631, 794	4. 47	96, 575, 371	30, 896, 255	2, 275, 514	11, 002, 730	6. 24	2. 36	7. 37	35. 61

	Total for 4-year period, 1917-1920, inclusive:													
100	Northeastern		31,527,444	1,813,041	5.75	72,653,756	21,228,175	2,100,602	7,960,397	6.86	2.89	9 90	37.50
37	Southern		7,281,203	226,601	3.11	45,183,058	15,641,881	271,553	5,777,792	3.73	6.01	1.74	38.74
53	Central		10,736,677	268,264	2.50	16,761,639	4,370,557	568,453	1,515,657	5.29	3.39	13.01	34.68
190	Grand total		49,545,324	2,307,906	4.66	134,598,453	41,240,613	2,940,608	15,253,846	5.94	2.18	7.13	36.99

Exhibit D.—*Bituminous coal mines—Summary of data obtained from special assessment division, income-tax unit*

	Number of companies reported	Total gross income	Net income			Depreciation	Depletion	Total taxes paid	Per cent depreciation to net operating income	Per cent depletion to—		Per cent depletion and depreciation to—		Per cent tax to net taxable income
			Taxable	Without depletion	Operating					Net income without depletion	Net operating income	Gross income	Net operating income	
Taxable year 1918:														
Northeastern district [1]	45	$89,828,838	$14,632,858	$16,969,477	$19,367,950	$2,398,479	$1,967,100	$7,340,263	12.38	11.59	10.16	4.86	22.54	50.16
Southern district [2]	51	43,955,826	10,408,395	11,552,915	14,100,618	2,447,766	819,618	4,747,758	17.36	7.09	5.81	7.43	23.17	45.61
Central district [3]	77	116,559,236	20,631,661	23,079,563	25,380,239	2,300,676	1,426,515	11,068,801	9.06	6.18	5.62	3.20	14.69	53.65
Total	173	250,343,900	45,672,914	51,601,955	58,848,876	7,146,921	4,213,233	23,156,822	12.14	8.16	7.16	4.54	19.30	50.70
Taxable year 1919:														
Northeastern district [1]	49	54,685,898	7,532,102	9,331,394	11,012,718	1,681,324	1,537,437	1,751,033	15.27	16.48	13.96	5.89	29.23	23.25
Southern district [2]	39	25,707,128	4,498,581	4,945,320	6,088,846	1,143,526	380,789	1,072,611	18.78	7.70	6.25	5.93	25.03	23.84
Central district [4]	62	78,460,302	8,670,444	10,070,606	11,701,367	1,640,761	1,050,835	1,956,740	14.02	10.43	8.98	3.43	23.00	22.57
Total	150	158,853,328	20,701,127	24,347,320	28,802,931	4,465,611	2,969,061	4,780,384	15.50	12.19	10.31	4.68	25.01	23.09
Taxable year 1920:														
Northeastern district [1]	45	57,980,193	14,207,407	16,488,662	18,035,980	1,547,318	1,336,964	4,411,641	8.58	8.11	7.41	4.97	15.99	31.05
Southern district [2]	45	45,117,813	11,446,158	12,222,428	13,621,519	1,399,091	357,952	4,229,687	10.27	2.93	2.63	3.89	12.90	36.95
Central district [3]	64	116,714,371	19,921,915	22,111,649	24,041,605	1,931,893	1,006,326	6,254,031	8.04	4.55	4.18	2.52	12.22	31.39
Total	154	219,812,377	45,575,480	50,822,739	55,699,104	4,878,302	2,701,242	14,895,359	8.76	5.32	4.85	3.45	13.61	32.68
Total for 3-year period, 1918-1920:														
Northeastern district [1]	139	202,494,929	36,372,367	42,789,533	48,416,654	5,627,121	4,841,501	13,502,937	11.62	11.31	10.00	5.17	21.62	37.12
Southern district [2]	135	114,780,767	26,353,134	28,720,663	33,811,046	4,990,383	1,558,359	10,050,056	14.76	5.43	4.61	5.71	19.37	38.13
Central district [4]	203	311,733,909	49,224,020	55,261,818	61,123,211	5,873,330	3,483,676	19,279,572	9.61	6.30	5.70	3.00	15.31	39.17
Grand total	477	629,009,605	111,949,521	126,772,014	143,350,911	16,490,834	9,883,536	42,832,565	11.50	7.80	6.89	4.19	18.40	38.26

[1] Pennsylvania.
[2] Maryland, West Virginia, Virginia, Tennessee, and Alabama.
[3] Illinois, Ohio, Kentucky, and Indiana.
[4] Illinois, Ohio, Kentucky, Indiana, and Michigan.

BARAGUA SUGAR CO., PITTSBURGH, PA.

The Baragua Sugar Co. was organized in the year 1916 under the laws of the State of Delaware. It commenced operating in 1917 in Cuba.

This taxpayer filed an income-tax return for the year 1922, indicating a tax liability of $2,327.23.

In his formal complaint made to the committee Mr. D. F. Hickey, formerly an employee of the Income Tax Unit, Internal Revenue Bureau, objects to the manner in which this taxpayer's 1922 return was handled in the unit. (See Exhibit A.)

Under date of February 21, 1923, Revenue Agent T. J. Arthur reported in regard to a transaction made by the taxpayer in 1922, which was not reported in his return, as follows:

"During July, 1922, the Baragua Sugar Co., together with the Punta Alegre Sugar Co., a Delaware corporation, formed a Cuban corporation known as the Compania Azucarera Baragua, with an authorized capital of 110,250 shares, having a par value of $50 a share and a bonded indebtedness of $4,500,000.

"On July 22, 1922, the Baragua Sugar Co. turned over to the Cuban corporation their Cuban assets, valued [1] at $6,147,420.08, amended per this audit, $6,169,-742.32, in exchange for 85,250 shares of the Cuban corporation and the entire bonded indebtedness of $4,500,000 par value.

"On July 26, 1922, the Baragua Sugar Co. exchanged the 85,250 shares of the Cuban corporation for 85,250 shares of the Punta Alegre Sugar Co., and sold for cash to the Punta Alegre Sugar Co. the $4,500,000 par value of bonds of the Cuban corporation, receiving therefor $4,250,000. The stock of the Cuban corporation was not listed on any exchange, but the stock of the Punta Alegre Sugar Co. was listed on the New York Stock Exchange and was traded in on July 26, 1922, having that day a 'high' of 51½ and a 'low'of 50, and a closing price of 50¼ and an opening of 50⅞; total shares traded, 5,600."

The Income Tax Unit held that under the provisions of section 202 (d) (1) of the revenue act of 1921 and article 1565, Regulations 62, that the above-mentioned transaction was taxable and as a result thereof under date of June 29, 1923, an A-2 letter was sent to the taxpayer notifying it of a proposed additional assessment of $293,794.26. (See Exhibit B.)

The taxpayer, under date of July 19, 1923, filed a brief (Exhibit C) protesting against the assessment of the additional tax mentioned above. In this brief the taxpayer claims, among other things, that the stock of the Punta Alegre Sugar Co. which it received was not regularly traded in in a public market in quantities which would establish a value on the basis of sales in quantities as in the instant case, and that this sale of 5,600 shares was an exceptional sale and does not establish the value of the 85,250 shares. The taxpayer further states that if this quantity of stock had been placed on the market it would have brought down the price and that it is not improbable that had such a large block as it received been sold, the price would have been driven down below $10 a share. It relies on article 1564 of Regulations 62 as an argument against the assessment of any tax on this transaction on the ground that the amount of stock which it received was of such an exceptional quantity that it had no readily realizable market value.

There were 232,823 shares of common stock of the Punta Alegre Sugar Co. outstanding on December 31, 1921. Lead pencil notations on the margin of the brief indicate that this stock was regularly traded in on the New York Stock Exchange and that over 17,000 shares were sold during the week preceding this transaction. Another notation states that, "The Baragua Sugar Co. shortly thereafter used a very large part of the Punta Alegre stock with which to purchase its own stock and has probably distributed the remaining shares to stockholders during 1923. This is proof positive that the stock was not held for investment purposes."

All of the lead-pencil notations on the margin of the brief, probably written by the auditor who handled the case, appear as Exhibit D.

Under date of July 26, 1923, a conference was held in the unit at which the taxpayer's contention was denied, the bureau's contention being sustained. After this denial the taxpayer had the right to appeal to the committee on appeals and review, which would have been the regular procedure if the taxpayer still believed his contention was correct and he sought relief. However, there is

[1] The revenue agent has evidently misused the word "valued" and meant "cost," as the bureau refers to the same figures as the cost of the assets in its letter of June 29, 1923 (see last sentence, penultimate paragraph, Exhibit B).

nothing in the record to show that the case was considered by, or even submitted to, the Committee on Appeals and Review.

The record shows that the taxpayer was represented by Mr. L. E. Rusch and Mr. W. A. Seifert, of Reed, Smith, Shaw & McClay, of Pittsburgh.

The record indicates that the case had been forwarded from corporation audit to the consolidated returns subdivision, section B, for the purposes of considering the matter of affiliation of this taxpayer with other corporations. It was determined that no affiliation existed as regards this taxpayer and the case was returned to the consolidated returns subdivision (the subdivision of which L. E. Rusch was formerly assistant chief) and the ruling form (Exhibit E) contains the following note:

"Recommend audit in consolidated returns subdivision by special request."

The record does not indicate by whom the special request referred to was made.

Under date of October 22, 1923, the deputy commissioner advised the taxpayer that, "The adjustment made in the previous bureau letter is reversed," and found that instead of an additional tax of $293,746 for the year 1922, that the tax liability for 1922 was $612.72, resulting in an overassessment of $1,714.51. The symbols on this letter indicate that it was prepared by Mr. C. P. Reilly, an employee of section B of the consolidated returns subdivision of the income-tax unit. (See Exhibit F.)

This case clearly shows that, subsequent to the conference held in the unit, it did not follow the regular procedure provided for taxpayers who wish to appeal. Instead of following the usual course to the committee on appeals and review, it was transferred by special request to the consolidated returns subdivision and the taxpayer given the relief which it was denied in conference.

Respectfully submitted.

Geo. G. Box, *Chief Auditor.*

Exhibit A

This case did not belong in consolidated (the term "consolidated" being applied to the consolidated returns subdivision and its successor, the consolidated returns audit division), and after having been ruled "not affiliated" was routed out of consolidated to the trading section of the corporation audit division, where it should have been audited. Year involved, 1922.

The case, however, was called back to consolidated to be audited there by "special request," such special request notation being made upon the nonaffiliated ruling forms (such ruling form being a single sheet of white paper appropriately printed), which previously had been made out.

The bureau had increased this corporation's income for 1922 by $2,364,070.12 on account of profits on sale of stocks and bonds of a Cuban sugar company, and the taxpayer filed a brief in protest. The brief was prepared by Reed, Smith, Shaw & McClay.

A conference was held July 26, 1923, at which W. N. Jackson and one Powderly, employees of L. E. Rusch, represented the taxpayer. (It has been said that Mr. Powderly subsequently was employed by the law firm of Reed, Smith, Shaw & McClay, Pittsburgh.) The bureau was represented by F. H. Delano, of the technical staff, and C. P. Reilly, auditor, section B, both employees of consolidated.

About 50 per cent of the receipts from the sale of the stock and bonds of the Cuban sugar company was represented by stock of the Punta Alegre Sugar Co., the other 50 per cent having been cash, and the bureau, in arriving at the value of the Punta Alegre Sugar Co. stock on the date of transfer, used as a basis the New York Stock Exchange quotation covering sales on that day of about 5,000 shares thereof.

The taxpayer's contention was denied following the conference, as the conference memorandum signed by F. H. Delano and C. P. Reilly, as of July 26, 1923, will show. A copy of this conference memorandum should be in the case, and another copy thereof should be in the file maintained for conference memoranda in the office of the technical staff, consolidated returns audit division.

Subsequent to the formal conference referred to, H. L. Robinson, chief of section B of consolidated, ordered Auditor C. P. Reilly aforesaid to allow the taxpayer's contention, despite the fact that this contention had been denied at the conference and that the regular procedure under such circumstances was an appeal to the committee on appeals and review, Robinson telling Reilly that a written authorization to do so, signed by L. T. Lohman, head of consolidated, would be given him to file in the case. Such written authorization, however, was never given to Auditor Reilly, according to his statements.

The regular procedure of the Income Tax Unit in cases where taxpayers were dissatisfied with decisions made after conferences and desired to appeal therefrom was the submission of such cases to the committee on appeals and review.

As a result of granting the taxpayer's contention in this case—irregularly, as has been shown—deficiency taxes of $293,794.26 for 1922 were abated and, instead, an overassessment of $1,714.51 was determined for that year.

This case was reported by complainant, D. F. Hickey, to Operative Frank J. Wilson, Special Intelligence Unit, Treasury Department. Final disposition unknown to complainant.

EXHIBIT B

[In pencil. June 29, 1923]

SCHEDULE 1.—BARAGUA SUGAR CO., YEAR ENDED DECEMBER 31, 1921

Computation of tax, 1921

Net income as shown in revenue agent's report dated Feb. 21, 1923	$485, 259. 81
Tax at 10 per cent	48, 525. 98
Previously assessed	44, 922. 15
Additional tax to be assessed	3, 603. 83

Inasmuch as the excess profits credit exceeds the taxable income, the computation of invested capital is not shown.

SCHEDULE 2.—BARAGUA SUGAR CO., YEAR ENDED DECEMBER 31, 1922

Income adjustments

Net income as shown in revenue agent's report dated Feb. 21, 1923	$111, 916. 72
As corrected	2, 475, 986. 90
Increase	2, 364, 070. 18

The increase shown above represents the profit derived from the sale to the Punta Alegre Sugar Co. of the stocks and bonds of the Compania Azucarera Baragua which you received in exchange for the assets of your company.

It is your contention that under the provisions of section 202 of the revenue act of 1921 no taxable gain was derived from this transaction.

It appears, however, under the provisions of section 202 (d) (1) that the 85,250 shares of stock and the $4,500,000 par value bonds which your company received from the Compania Azucarera Baragua must be treated as taking the place of the property exchanged therefor, namely, your Cuban assets. The cost of these assets as adjusted by the revenue agent is $6,169,742.32.

The determination of the income derived from the exchange of the stocks and bonds of the Compania Azucarera Baragua for cash in the amount of $4,250,000 and 85,250 shares of stock of the Punta-Alegre Sugar Co. clearly falls under the provisions of article 1565 of Regulations 62, since the stock of the Punta Alegre Sugar Co. did have a readily realizable market value. This transaction does not fall within the provisions of article 1566 since it is clear that the stocks and bonds exchanged were not held by your company for investment purposes.

The computation of the profit is as follows:

Property received from Punta Alegre Sugar Co.:	
Cash	$4, 250, 000. 00
Stock—85,250 shares at $50.25 ($50.25 was the closing price on the New York stock exchange July 26, 1922, the date of the transaction)	4, 283, 812. 50
	8, 533, 812. 50
Property given in exchange:	
Stock of Compania Azucarera Baragua, 85,250 shares; bonds of Compania Azucarera Baragua, $4,500,000, par value	6, 169, 742. 32
Profit on the transaction	2, 364, 070. 18

SCHEDULE 3

Computation of tax, 1922

Net income as corrected (schedule 2)	$2,475,986.90
Income at 12½ per cent	309,498.36
Less income taxes paid to Cuban Government	13,376.87
Balance of tax	296,121.49
Previously assessed	2,327.23
Additional tax to be assessed	293,794.26

Exhibit C

Before the Treasury Department in the matter of the audit of the income and excess profits tax returns, filed by the Baragua Sugar Co., Pittsburgh, Pa., for the taxable years 1921 and 1922

APPLICATION FOR RECONSIDERATION

IT:SA:CR:B-CPR

This is an application for reconsideration of the findings made by the Bureau of Internal Revenue, as embodied in letter dated June 29, 1923, showing additional tax as follows:

1921	$3,603.83
1922	293,794.26
Total tax	297,398.09

HISTORY OF PROCEEDINGS

On February 21, 1923, Revenue Agent T. J. Arthur submitted a report covering the taxable years 1921 and 1922, showing $3,603.83 additional tax for 1921 and an overassessment of $1,714.51 for 1921 and 1922, making a net additional tax of $1,889.32. On June 29, 1923, the bureau issued an assessment letter, showing additional taxes amounting to $297,398.09.

The increased additional tax shown by the bureau's letter is based on an alleged profit made by the corporation as a result of a reorganization.

In accordance with article 1566, regulations 62, no gain or loss resulted from this reorganization. The bureau, however, has taxed the alleged profit under article 1565, regulations 62.

HISTORY OF REORGANIZATION

The Punta Alegre Sugar Co. desired to consolidate with the Baragua Sugar Co. Under their charter this action was impossible without the consent of the stockholders.

For this reason during July, 1922, the Baragua Sugar Co. and the Punta Alegre Sugar Co. formed a corporation under the laws of Cuba, known as the Compania Azucarera Baragua, with an authorized capital of 110,250 shares and a par value of $50 a share.

On July 22, 1922, the Baragua Sugar Co. turned over to the Cuban corporation all of its Cuban assets, valued at $6,147,420.08 (as amended by the revenue agent's report, $6,169,742.32) in exchange for 85,250 shares of stock and $4,500,000 par value bonds of the Compania Azucarera Baragua.

On July 26, 1922, the Baragua Sugar Co. exchanged stock and bonds of the Compania Azucarera Baragua for 85,250 shares of Punta Alegre Sugar Co. and $4,250,000 cash.

The bureau contends—

1. That the stock of the Punta Alegre Sugar Co. had a "readily realizable market value."

2. That this exchange is taxable under article 1565, because of the alleged fact that the stock and bonds of the Cuban corporation were not held for investment.

The taxpayer respectfully contends that the bureau has misinterpreted the parenthetical phrase used in article 1565, regulations 62, i e., "readily realizable market value."

Article 1564, regulations 62, defines this phrase as follows:

"Property has a readily realizable market value, if it can be readily converted into an amount of cash or its equivalent substantially equal to the fair value of the property. In other words, the property received in exchange must be readily marketable at substantially its fair value in order that a gain or loss be recognized. Property which is regularly traded in in a public market has a readily realizable market value in the quantities regularly traded in. Property may be salable, as in the case of forced sale or in exceptional quantities, without having a readily realizable market value. * * *."

The bureau contends that the sale of 5,600 shares of Punta Alegre Sugar Co. stock established the fact that this stock had a "readily realizable market value." Again, it appears that the bureau has ignored the fact that the above-quoted article 1564 states that the stock must be regularly traded in in order to use the sales as a means of establishing values.

Such is not the case in this instance. The stock of the Punta Alegre Sugar Co. was not regularly traded in in a public market in quantities which would establish a value on the basis of sales in quantities, as in the instant case. This sale of 5,600 shares, was an exceptional sale, and does not establish the value of the 85,250 shares of stock. If this quantity of stock had been placed on the market, it would have brought down the price. In fact, it is not improbable that the offering for sale of such a large quantity of this stock, would have driven the price below $10 a share. It is urgently contended that this sale can not be used as a criterion of the value of the entire 85,250 shares, for the reason that this quantity was not regularly traded in neither before nor after this isolated transaction occurred, and according to the regulations quoted above it did not have a readily realizable market value.

In view of the fact that the stock of the Punta Alegre Sugar Co. has no "readily realizable market value," section 202 (c) of the revenue act of 1921 applies. In this connection the following excerpt is quoted:

"Where property is exchanged for other property which has no readily realizable market value, together with money or other property which has a readily realizable market value, then the money or the fair market value of the property having such readily realizable market value received in exchange shall be applied against and reduce the basis provided in this section of the property exchanged and, if in excess of such basis, shall be taxable to the extent of the excess: * * *.

Applying the above section of the law to this particular case, it may be readily seen that no loss or gain resulted from this exchange of bonds and stock for cash and stock.

The following illustration proves this fact conclusively:

Value of bonds and stock transferred	$6, 169, 742. 32
Cash received	4, 250, 000. 00
Excess cost	1, 919, 742. 32

This excess cost according to the law is to be applied against the amount realized from the subsequent sale of the stock received before any taxable profit accrues on the transaction.

The above arguments, even though very simple, are presented to prove the fallacious attitude of the bureau.

The second point is easily disposed of by the simple fact that this company is not in the brokerage business but in the sugar business. Therefore its capital outlay becomes ipso facto an investment eliminating the trading feature automatically.

The taxpayer does not contend that this transaction, which the bureau has taxed, comes under any of the regulations quoted above. It is respectfully contended that this transaction comes squarely within the purview of section 202 (c) 2, which states that no loss or gain results from an exchange of property—

"When, in the reorganization of one or more corporations, a person receives in place of any stock or securities owned by him stock or securities in a corporation a party to or resulting from such reorganization. The word 'reorganization,' as used in this paragraph, includes a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or of substantially all the properties of another corporation), recapitalization, or mere change of identity, form, or place of organization of a corporation (however effected); * * *."

This transaction was primarily a "reorganization." The stock holders of all companies concerned considered it as such, giving due consideration to section 202 (c) 2 of the revenue act of 1921 at the time of the reoganization.

Attention is respectfully invited to the definition of the word "reorganization" given in the above-mentioned section of the law:

"The word 'reorganization,' as used in this paragraph, includes a merger, consolidation (including the acquisition by one corporation of at least a majority of the voting stock * * *, or substantially all the properties of another corporation. * * *.)"

In this particular reorganization, the Punta Alegre Sugar Co. consolidated its properties with the properties of the Baragua Sugar Co.

The law states that the acquisition of "substantially all the properties" of a company constitutes a "reorganization." In this case, the Punta Alegre Sugar Co. acquired all the properties of the Baragua Sugar Co.

The manner in which this reorganization was carried out has no bearing whatsoever on the subject. The law is very broad in its interpretation of the word "reorganization," and closes the interpreting sentence with the words "however effected," which leaves no doubt as to the exact meaning Congress desired to place upon the word "reorganization."

In view of the above facts and circumstances and the clearness of the law on this point, the bureau is respectfully requested to revise its findings in this case in accordance with the revenue agent's report.

Respectfully submitted.

[CORPORATION SEAL.] THE BARAGUA SUGAR CO.,
(Signed) By JAMES D. CALLERY, *President.*

Attest:
(Signed) LLOYD W. SMITH, *Secretary.*

STATE OF PENNSYLVANIA,
County of Allegheny, ss:

On this 19th day of July, 1923, before me personally appeared James D. Callery, president of the Baragua Sugar Co., Pittsburgh, Pa., to me known, who, being by me duly sworn, deposes and says that the facts set out in the foregoing brief are true and correct to the best of his knowledge and belief.

[SEAL.] (Signed) EDWARD J. HENIFER,
Notary Public.

My commission expires March 8, 1925.

EXHIBIT D

PENCIL NOTATIONS ON BRIEF

Punta Alegre Sugar Co. had 232,823 shares common outstanding December 31, 1921, par value $50 per share.

The only point raised by the taxpayer worth while considering is whether the number of shares traded in on the New York Stock Exchange is sufficiently large to establish the value of the 85,250 shares which entered into this transaction.

This stock was regularly traded in on the New York Stock Exchange. Over 17,000 shares were sold during the week preceding this transaction. The price was around $50 at all times.

Sales of Punta Alegre stock on the New York Stock Exchange were as follows for the week preceding this transaction:

Date	Number of shares	Date	Number of shares
July 19	4,600	July 24	1,200
July 20	2,200	July 25	3,300
July 21	300	July 26	5,600
July 22	100		

This was a new issue and represented new assets owned by Punta Alegre and would not have forced down the price more than a few dollars at the very most.

What might have happened had this stock been thrown on the market should not be considered. We should be guided by what did happen.

The Baragua Sugar Co. shortly thereafter used a very large part of the Punta Alegre stock with which to purchase its own stock and has probably distributed the remaining shares to stockholders during 1923. This is proof positive that the stock was not held for investment purposes.

Yes, this is a reorganization, but this transaction does not fall under section 202 (c) 2 because in this case a very large part of the consideration received was cash. In order to meet the requirements of section 202 (c) 2 the sole consideration received must be stock or securities. That the sole consideration received must be stock or securities is made particularly clear in article 1566 of regulations 62 (p. 312, lines 10, 11, and 21).

EXHIBIT E

NOT AFFILIATED

[To be attached to return of company when case is sent to administrative section as not affiliated]

Ruling Form, Consolidated Returns Subdivision, Section B

All companies in a single case, determined to be not affiliated for any one year should be listed hereon. One sheet for each taxable year.

NAME OF TAXPAYER, BARAGUA SUGAR CO.,
ADDRESS, PITTSBURGH, PA.

Consolidated files. (Date) JUNE 8, 1923.

The following companies are not affiliated for the year 1922. A consolidated return has not been filed.

L. J. P.

Companies: Baragua Sugar Co.
Recommend audit in consolidated returns.
Subdivision by special request.

(Signed) HENRY W. MUNSON,
Resident Auditor.

Unit Auditor.

Ruling letter written, no.

Basis for ruling: (Signed) L. J. POTTER,
Section B, Unit Aff.

Questionnaire.
Conference.
Correspondence (in ink). R. A. R., 3/12/23.

EXHIBIT F

Registered.
OCTOBER 22, 1923.

IT:CR:B
CPR–App.

BARAGUA SUGAR COMPANY,
810 Union Bank Building, Pittsburgh, Pa.

SIRS: A reexamination of your income-tax returns for the years 1921 and 1922 discloses an additional tax liability for 1921 of $3,603.83 and an overassessment of $1,714.51 for 1922, as shown in detail in the attached statement.

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,

(Signed) C. B. ALLEN,
Acting Deputy Commissioner.

Inclosures:
Statement.
Revised schedules 2 and 3.
1sp-1

IT: CR-E
CPR

SCHEDULE 2, REVISED

In re: Baragua Sugar Co., Pittsburgh, Pa., year ended December 31, 1922

Net income shown in bureau letter dated June 29, 1923	$2,475,986.90
As corrected	111,916.72
Net decrease as explained below	2,364,070.18

Reasons for changes

Your contention that under the provisions of section 202 of the revenue act of 1921 no taxable gain was derived from the exchange of the stocks and bonds of the Compania Azucarera Baragua for cash, in the amount of $4,250,000 and 85,250 shares of stock of the Punta-Alegre Sugar Co., has been allowed. Accordingly the adjustment made in the previous bureau letter is reversed.

SCHEDULE 3, REVISED

Computation of tax, 1922

Net income as corrected (schedule 2, revised)	$111,916.72
Income tax at 12½ per cent	13,989.59
Less:	
Income taxes paid to Cuban Government	13,376.87
Balance of tax	612.72
Previously assessed	2,327.23
Overassessed	1,714.51

1sp-1.

OCTOBER 3, 1925.

In re Baragua Sugar Co., Pittsburgh, Pa.
Mr. C. R. NASH,
Assistant to the commissioner.

A review has been made of the report to the Senate investigating committee, submitted by Mr. George G. Box, chief auditor, in which criticism was made as to the procedure followed by the Income Tax Unit in reducing the tax liability of the Baragua Sugar Co. for the year 1922 from a proposed tax liability of $296,121.49 to a tax liability of $612.72.

The reduction in tax liability resulted wholly from the treatment of an amount of $2,364,070.18 as a taxable profit in computing the proposed tax of $296,121.49 and in eliminating the amount as a taxable profit in computing the final tax liability of $612.72.

The Baragua Sugar Co. was a corporation organized in 1916 under the laws of Delaware and operated in Cuba. During July, 1922, the Baragua Sugar Co., together with the Punta-Alegra Sugar Co., a Delaware corporation, formed a Cuban corporation known as Compania-Azucarera Baragua, with an authorized capital stock of 110,250 shares, par value $50 per share, and a bonded indebtedness of $4,500,000.

On July 22, 1922, the Baragua Sugar Co. turned over to the Cuban corporation their Cuban assets, valued at $6,147,420.08 (amended per audit, $6,169,742.32) in exchange for 85,250 shares of the Cuban corporation and the entire bonded indebtedness $4,500,000 face value.

Four days later, July 26, 1922, the Baragua Sugar Co. exchanged its 85,250 shares of the Cuban corporation to the Punta-Alegra Sugar Co. for 85,250 shares of the latter's stock, and sold for cash to the Punta-Alegra Co. the $4,500,000 bonds for $4,250,000. The stock of the Cuban company was not listed on any exchange, but the Punta-Alegra stock was listed on the New York Stock Exchange and was traded in on July 26, 1922, having that day a "high" of 51½, a "low" of 50, a closing price of 50¼, and an opening of 50⅞; total shares traded, 5,600.

The revenue agent who reported these facts and submitted a report of tax liability under date of March 12, 1923, for the years 1921 and 1922 did not show any taxable profit on this transaction, presumably agreeing with the taxpayer that under section 202 (c) (2) of the revenue act of 1921 no taxable profit resulted.

In a tentative assessment letter mailed June 29, 1923, showing the proposed tax liability of $296,121.49 for 1922, the unit computed a taxable profit of $2,364,070.18 on the exchange, the letter reading:

"The increase shown above represents the profits derived from the sale to the Punta Alegra Sugar Co. of the stocks and bonds of the Compania Azucarera Baragua which you received in exchange for the assets of your company.

"It is your contention that under the provisions of section 202 of the revenue act of 1921 no taxable gain was derived from this transaction.

"It appears, however, under the provisions of section 202 (d) (1) that the 85,250 shares of stock and the $4,500,000 par value bonds which your company received from the Compania Azucarera Baragua must be treated as taking the place of the property exchanged therefor, namely, your Cuban assets. The cost of these assets as adjusted by the revenue agent is $6,169,742.32.

"The determination of the income derived from the exchange of the stocks and bonds of the Compania Azucarera Baragua for cash in the amount of $4,250,000 and 85,250 shares of stock of the Punta Allegra Sugar Co. clearly falls under the provisions of article 1565 of regulations 62, since the stock of the Punta Alegra Sugar Co. did have a readily realizable market value. This transaction does not fall within the provisions of article 1566, since it is so clear that the stocks and bonds exchanged were not held by your company for investment purposes."

The profit shown in the assessment letter was computed as follows:

Property received from Punta Alegra Sugar Co.:		
Cash		$4,250,000.00
Stock, 85,250 shares at $50.25 ($50.25 was the closing price on the New York Stock Exchange July 26, 1922, the date of the transaction)		4,283,812.50
		8,533,812.50
Property given in exchange:		
Stock of Compania Azucarera Baragua, 85,250 shares; Bonds of Compania Azucarera Baragua, $4,500,000	par value	6,169,742.32
Profit on transaction		2,364,070.18

The taxpayer protested the proposed assessment by an appeal dated July 19, 1923, claiming, among other reasons, that no taxable profit resulted under section 202 (c) (2) of the revenue act of 1921.

Under date of July 26, 1923, a conference was held in the unit at which the taxpayer's contention was denied, the bureau's contention being sustained. After this denial the taxpayer had the right to appeal to the Committee on Appeals and Review, which would have been the regular procedure if the taxpayer still believed his contention was correct and he sought relief.

It is evident that subsequent to the conference the unit reconsidered its action and allowed the taxpayer's contention, thereby not necessitating consideration of the taxpayer's contention by the Committee on Appeals and Review, which body was created for the purpose of considering appeals by taxpayers who were denied their contentions in the unit.

The Senate investigating committee's auditor, Mr. Box, in his report criticizes the action of the unit, and the inference from the wording of his report is that the taxpayer was erroneously allowed to escape paying tax on the amount of $2,364,070.18. The last paragraph of the report of Mr. Box, after detailing previous steps of the case, reads:

"This case clearly shows that, subsequent to the conference held in the unit, it did not follow the regular procedure provided for taxpayers who wished to appeal. Instead of following the usual course to the Committee on Appeals and Review, it was transferred by special request to the consolidated returns subdivision and the taxpayer given the relief which it was denied in conference."

In reviewing the taxpayer's case on its merits, it appears that no taxable profit was realized by the Baragua Sugar Co. on the exchange of the Cuban company's stock for stock of the Punta-Allegra Co. and, therefore, the action of the Income Tax Unit in determining a tax liability for the year 1922 of $612.72 instead of $296,121.49 was correct, and any criticism by the Senate investigating committee as to an error in determining the correct amount of tax due from this taxpayer is unwarranted.

Section 202 (c) (2) of the revenue act of 1921, relating to the basis for determining a gain or loss, reads (italics mine):

"(c) For the purposes of this title, on an exchange of property, real, personal, or mixed, for any other such property, no gain or loss shall be recognized unless the property received in exchange has a readily realizable market value; *but even if the property received in exchange has a readily realizable market value, no gain or loss shall be recognized.*

* * * * * * *

"(2) When in the reorganization of one or more corporations *a person receives in place of any stock or securities owned by him, stock or securities in a corporation a party to or resulting from such reorganization.* The word 'reorganization' as used in this paragraph, includes a merger or consolidation (*including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or of substantially all the properties of another corporation*), recapitalization, or mere change in identity, form, or place of organization of a corporation (however affected); * * *."

Section 2 of the revenue act of 1921 reads:

"That when used in this act—

"(1) The term 'person' includes partnerships and corporations, as well as individuals; * * *."

From a close reading and analysis of the wording of section 202 (c) (c) as quoted above, there can be no doubt but that the Baragua Sugar Co. did not realize any taxable gain when it received in place of the stock of the Compania Azucarera Baragua owned by it, stock in the Punta-Allegra Sugar Co., a party to the reorganization, the term "reorganization" being expressly applicable in this case under the wording of section 202, as the Punta-Allegra Co. acquired all the properties of another corporation—namely, the Compania Azucarera Baragua.

The bonds, having a face value of $4,500,000, were sold for $4,250,000 cash by the Baragua Sugar Co. to the Punta-Allegra Sugar Co., apparently at a definite price, and this should not affect the amount of gain or loss on the transfer of the stock of the Cuban company between the other two companies.

In the taxpayer's brief it is stated that the reorganization was arranged by the stockholders after giving due consideration to section 202 (c) (2) of the revenue act of 1921, and presumably the reorganization was literally effected so as to avoid the payment of an income tax in accordance with the language of the law as passed by Congress.

In Mr. Box's report, sole reference has been made to section 202 (d) (1) of the revenue act of 1921, without having considered the provisions of section 202 (c) (2), and it is believed that upon reconsideration of the matter Mr. Box will concur with the findings of the Income Tax Unit that no taxable profit resulted from the transaction and, therefore criticism of the unit in the determination of tax liability on this case is unwarranted.

Under date of February 16, 1924, the returns of the Baragua Sugar Co. for 1921 and 1922 were closed under the provisions of section 1312 of the revenue act of 1921.

(Signed) C. B. ALLEN,
Acting Deputy Commissioner.

JULY 7, 1925.

In re Louis Blaustein, Baltimore, Md.

Revenue Agents Joseph M. Fendley and Ernest A. Weller, of the Baltimore (Md.) office, in conjunction with Sam W. Maples, special agent of the Special Intelligence Unit of the Bureau of Internal Revenue, made an examination of this taxpayer for the years from 1913 to 1919, inclusive.

Under date of November 3, 1920, the revenue agents submitted a report in which they recommended the assessment of additional tax and penalties as follows:

Year	Additional tax disclosed	Penalties	Per cent	Total tax and penalties
1913	$74.98			$74.98
1914	96.66			96.66
1915	153.14			153.14
1916	1,593.40			1,593.40
1917	7,282.58	$7,282.58	100	14,565.16
1918	11,522.13	5,761.07	50	17,283.20
1919	26,643.17	13,321.59	50	39,964.76
Total	47,366.06	26,365.24		73,731.30

The agents state that the taxpayer kept no regular set of books, although his gross business in the years 1918 and 1919 was practically $1,500,000 per annum, and that up to the year 1919 practically all the records available were his charge accounts. In order to arrive at the tax liability of this taxpayer they computed the assets and liabilities as near as possible from the records at hand as of December 31, 1919, and worked back to the year 1913.

The taxpayer's records for the year 1919 were such that an examination could be made of his entire business with the exception of inventory, no inventory having been taken on December 31, 1919, and the amount, $36,375, which was used by the taxpayer in his return, was an arbitrary figure and nothing could be found of record to substantiate it.

The taxpayer advised the agents that the inventory "ran along about the same in the last six months of the year, and an inventory was located among his son's papers as of June 30, 1919." This inventory showed a total of $66,043.51.

The revenue agents, prior to the examination on account of which this report was made, had attempted to examine the taxpayer's returns, but stated that verification thereof could not be made because of the unintelligible records which he kept. The revenue agent in charge, in transmitting the above-mentioned report to the Commissioner of Internal Revenue, recommended that the additional taxes and penalties mentioned therein be assessed.

Under date of November 16, 1920, Special Agent Sam W. Maples submitted a report to the chief of the Special Intelligence Unit, recommending additional taxes of $20,732.49 for the years from 1913 to 1918, inclusive, and $26,643.17 for the year 1919, a total of $47,375.66. He states that the taxpayer operated under the name of the American Oil Co.; that after considerable hesitancy, upon his demand to open his safe and allow them access to his son's desk, he acquiesced and that no books or papers were found in the safe. However, in his son's desk copies of financial statements rendered to banks and mercantile agencies at various times purporting to show his net worth were found, as well as inventories of the various branches operated; also the amount spent or drawn out of the business for living expenses, etc. These reports were in the handwriting of Jake Blaustein, the son, which were identified by his father as such.

He states that the taxpayer employed the clerks whom he called bookkeepers, but none of whom were ever informed sufficiently as to taxpayer's business to enable them to keep records which would reflect the taxpayer's net income or present worth until the year 1919. He states further:

"I am convinced that this taxpayer had an ulterior motive in keeping grossly incomplete records, and his motive was to evade paying his income tax. Agents Fendley and Weller and Revenue Agent in Charge Graham, who is conversant with all the facts, agree with me, but I am equally as convinced that he can not be successfully prosecuted for his evasion. We are here, as in many other cases, square up against the lamentable fact that you can not prosecute for failure to keep records."

He concludes by recommending the assessment of the additional tax above mentioned, and also that the penalty for filing false and fraudulent returns attach. This report was transmitted by the chief of the special intelligence unit to Mr. Newton (attention of Mr. Alexander) concurring in the recommendation of Mr. Maples.

Under date of November 26, 1920, the revenue agent in charge at Baltimore forwarded to the Commissioner of Internal Revenue a supplemental report of Revenue Agents Ernest A. Weller and Joseph Fendley, in which, among other things, they stated as follows:

"No books or records of any kind were found that in any way reflect his income during any of the years in question, although in 1917, 1918, and 1919 his gross business exceeded $1,000,000. He stated that he did not want any books for the reason that he did not want any of his employees to know any of the details of his business for fear it would be reported to the Standard Oil Co., as he used to work for that company for a period of 18 years and knew how they obtained information about others engaged in the same kind of business.

"Shortly after beginning the examination the taxpayer's son, Jacob, who apparently knew more of the details of the business than the taxpayer himself, became ill and was sent to Lake Saranac, N. Y., for an indefinite period. The taxpayer continually referred to this son, and appeared to desire to shift the responsibility of any defects in his income tax return to the son, claiming that he made them out for years prior to 1918. He stated that he never heard of the income tax law prior to this country's entry into the war, although he actually filed returns from the beginning of the income tax law.

"For the years 1918 and 1919 his returns were made out by his auditor, J. R. Hugg, and the taxpayer apparently desires to shift the responsibility for any defects in the returns for these years to his auditor."

Mr. Blaustein insists that the financial statements found in his son's desk are grossly inflated, but in many items we can show that they are approximately correct, depreciation having been taken into consideration in the case of the fixed assets.

"The following comments by Dun and Bradstreet appear on comparative financial statements from March 1, 1913, to June 30, 1919: 'This comparison of exhibits shows a steady and favorable increase in the assets and net worth of the business, the increase being particularly marked within the past five years. The statement is regarded as a correct showing of the affairs of the business. Such assets amount to $270,134.86, as against current liabilities of $101,958.48, which leaves a very favorable margin. Authorities consulted after making some allowance for contingencies estimate the financial responsibility conservatively at upward of $250,000.' (The financial responsibility of upward of $250,000 is as of June 30, 1919. Our statement as of December 31, 1919, shows the net worth to be $271,672.94.)

"Mr. Blaustein claims no inventory has ever been taken, that inventory $36,375 shown on his return at December 31, 1919, was guessed at, but as a matter of fact it was discovered that he carries a perpetual inventory on many articles of merchandise. These items were compiled and make a total of $39,160.52, thereby showing conclusively that the inventory as of December 31, 1919, was understated. Many articles could not be obtained, and we have therefore used the amount of $66,043.51, the same amount used by him in making out a financial statement as of June 30, 1919.

"It is thought that in addition to being penalized, this individual should be prosecuted for filing false and fraudulent returns for the years 1913 to 1919, inclusive."

In his letter transmitting this report to the commissioner, the revenue agent in charge at Baltimore suggests that consideration be given to prosecuting this taxpayer for having filed false and fraudulent returns, in addition to passing upon the question of the ad valorem penalties set forth in his report of November 20, 1920.

On December 6, 1920, Ben Brown, of Lawrence, Brown & Coxeter, wrote to Mr. S. Alexander, of the Income Tax Unit, advising him that he would appear at the latter's office on Wednesday morning, together with Mr. Louis Blaustein.

On December 9, 1920, a conference memorandum signed by S. A. (S. Alexander) indicates that a hearing was given to Mr. Blaustein and Mr. Ben Brown, attorney, by Mr. Alexander, at which the taxpayer contended "that the findings of the investigating officers as transmitted by them were erroneous and that taxpayer had employed an accountant to submit to the department a statement showing his income for the various years." He stated that he had kept no books, but that he had all available records so that an analysis could be made of his income for the various years under discussion. The taxpayer was informed that a grant of 30 days would be given him in which to submit such statement, and that the investigating officer's report would be held in abeyance until that time.

Under date of February 2, 1921, the chief of the inventory section forwarded to Mr. Alexander a letter from Arthur G. Jacobs, auditor of the inventory section, in relation to taxpayer's inventory, in which he stated as follows:

"I am informed that in a recent examination of above company's books by an internal-revenue agent as to income and excess-profits tax liability that a number of records were not available, the taxpayer stating that the records requested by the revenue agent were destroyed in a fire that occurred on the premises shortly before the examination began.

"Later information has come to the writer that none of the records were destroyed and that very irregular practice existed in the preparation of pay rolls during the taxable years 1917, 1918, and 1919. More detailed information in these matters may be obtained from Mr. William Gillespie, in the office of the Maryland State auditor; also Mr. C. L. Staples, of the Baltimore Auto Service Co.

"I understand that an additional tax was assessed as a result of the examination, which was accepted by the taxpayer with apparent reluctance, but in reality with inward glee * * *."

Under date of March 21, 1921, Messrs. J. C. Eckel and C. C. Dannaker, auditors in the Internal Revenue Bureau, made a report to the commissioner. They report that the taxpayer kept no records prior to the year 1918 except of accounts receivable and accounts payable, but these were destroyed by fire. They refer to conversations had with taxpayer, his son, and employees and arrive at the conclusion that the taxpayer's statement in regard to his methods of bookkeeping prior to the year 1918 is true, and that there was ground for belief in the statement of the son that the financial statements found by the revenue agents in the latter's desk were mere inventions.

Referring to the reports of the revenue agents and the special intelligence agent, the auditors express the opinion that these reports show that their recommendations of the assessment of penalties for filing false and fraudulent returns were based upon opinions and not on facts, and they recommed that the returns of the taxpayer for the years prior to the year 1919 be accepted as originally made, that no penalties be assessed, and that additional tax for the year 1919 be assessed in the amount of $5,333.28. The report of the auditors appears as Exhibit A.

Under date of June 2, 1921, the bureau addressed an A-2 letter to the taxpayer, advising him that there was no tax due for the years from 1913 to 1918, inclusive, and additional tax for 1919 was $5,333.28.

This letter shows that the net income reported by taxpayer for 1919 of $27,334.48 was increased as a result of examinations made by employees of the Internal Revenue Bureau to $46,221.15. The tax originally paid for 1919 was $3,336.90. As a result of the examinations it was increased to $8,670.19, or about 160 per cent.

The record in this case shows that Agents Weller and Fendley attempted to make an examination of this taxpayer's returns and were unable to do so because of unintelligible records; that subsequently Special Agent Sam W. Maples, from the Special Intelligence Unit, was detailed to assist them, and after considerable trouble and much hesitance on the part of the taxpayer they succeeded in persuading him to make available the contents of his safe and his son's desk, where records were kept, which the taxpayer failed to produce upon the first attempt of the revenue agents to make an examination.

The revenue agents, as well as the special agent, made reports recommending additional tax for the period from 1913 to 1919, inclusive, of approximately $47,375.66, and the former recommended in their report the assessment of penalties aggregating $26,365.24. These three men came into contact with Blaustein and his son in the former's office, examined all of the records which were available, and were in position to make intelligent reports of actual conditions, and their reports should be given the fullest consideration. In spite of this fact their reports were examined by two auditors in the bureau, from whose report it appears that their examination was confined to questioning the taxpayer, his son, and employees (and not their records), and as a result their recommendation was accepted as to the final tax liability of this taxpayer and the report of the revenue agents and special agent cast aside.

It is very interesting to note that according to their report the taxpayer had an accounting system in 1919 but none prior to that time, yet in 1919, when this supposed system was in effect, the auditors concluded that he had understated his net income by about $20,000 and found an additional tax of about 160 per cent of the original tax paid for that year. If these conditions prevailed when taxpayer had records, the amount of tax he avoided in years prior to 1919 when he had no system of accounting is left to the imagination. Yet Auditors Eckel and Dannaker reached the conclusion that no additional tax for these years should be assessed. This is another case where the bureau fails to recognize the importance of the work of the men in the field who actually examine the books and records and are in position to know the facts, and in preference accept a report of auditors who are employed at desks in Washington and are not in position to acquire the facts and come in contact with the records, environment, and reputation of a taxpayer.

From the records in this case it is evident that the taxpayer has been relieved of the payment of additional taxes exclusive of penalties of approximately $42,000, for which he was undoubtedly liable.

GEO. G. BOX,
Chief Auditor.

GGB:BD.

EXHIBIT A

In re: Louis Blaustein, Baltimore, Md., 910 American Building

MARCH 21, 1921.

COMMISSIONER OF INTERNAL REVENUE:

The following is the report of the special investigation of the income and excess profits tax liability of the above-named individual for the years for which those taxes were assessible, up to and including the calendar year 1919.

The taxpayer passed his youth in the employ of the Baltimore Gasoline Co. where he learned the business of refining. After the Standard Oil Co. established a branch in Baltimore he obtained a position with it and remained in its employ for approximately 20 years. About the year 1910 he gave up his position with the latter company and embarked in business on his own account.

He is now engaged in the business of buying and selling gasoline, coal oil, and lubricating oil. His largest competitor is the Standard Oil Co. The prices of the commodities dealt in by the taxpayer are practically fixed by it, and therefore the percentage of net profit to its competitors on the volume of their business is comparatively small. In the instance of this taxpayer the gross profit ranges between 12¼ and 12½ per cent on sales, and the net profit between 2¼ and 2½ per cent.

The educational opportunities of his youth were limited; he has no knowledge of bookkeeping, and during the early years of his business, did not employ a bookkeeper. Many of the matters that are usually kept in accounts he carried in his head; and although he now has installed a fairly good accounting system, he still continues this practice. He knows his gross profit on sales and the percentage of his cost of doing business. He attends personally to the merchandise end and the financing of the business, and his son and other employees attend to the operating end.

The biographical references contained in the preceding paragraphs were obtained through conversations with the taxpayer, and other matters referred to were obtained by observation and investigation.

He claims that he kept no records prior to the year 1918 except of accounts receivable and accounts payable, and that these were destroyed by fire.

When the time for filing a return for the year 1917 approached, he began to realize the necessity for a method of bookkeeping that would furnish the information required for income-tax purposes. At the beginning of 1918 an attempt was made to install a system, but at that time he did not have a competent bookkeeper in his employ, and only fragments of a system were installed. At the beginning of the year 1919 a competent man was employed, who has installed a fairly good system of accounts, and now the net income from his business can be fairly ascertained.

Fully a week was spent in a search for records for the years under investigation prior to the year 1919; the search was futile, however, as only fragmentary records and canceled checks for the year 1918, and no records at all for the years prior to 1918 could be found.

A record of the sales for nine months of the year 1918 was found, and a comparison of the total monthly sales shown by this record with the total monthly sales for the same period as shown in the statement of sales used in the return for the year 1918 indicated that the latter amount had been overstated by approximately $20,000.

The taxpayer and his son were questioned concerning the financial statements discovered by the revenue agents who made the original investigation. The father told us that his son made them out unknown to him, and this statement was corroborated by the son. The latter said that they were prepared for the purpose of their submission to commercial agencies, and that in order to influence the credit rating given by these agencies the statements were grossly exaggerated.

A special agent from the Special Intelligence Unit investigated this case, and the following are quotations from his report:

"There is no evidence to refute Blaustein's statement that he has kept an unintelligible set of books since 1910."

* * * * * * *

"I am convinced that this taxpayer had an ulterior motive in keeping grossly incomplete records, and his motive was to evade paying his income tax. Agents Fendley and Weller and Revenue Agent in Charge Graham, who is conversant with all the facts, agree with me, but I am equally as convinced that he can not be successfully prosecuted for his evasion. We are here, as in many other cases, square up against the lamentable fact that you can not prosecute for failure to keep records."

The special intelligence agent, the revenue agents, and these auditors are all agreed as to the nonexistence of records for the years prior to 1918 and to the existence of only partial records for the year 1918. From conversations with the taxpayer, his son, and employees, and observations made during the investigation, it is believed by these auditors that there is truth in the statement of the taxpayer as to his methods of bookkeeping prior to the year 1918; therefore there is ground for belief in the statement of the son that the financial statements were inventions.

The Government is not concerned with the purpose or object of the financial statements, its concern being as to whether they are correct or not.

The reports of the revenue agents and special intelligence agent show that their recommendations of the assessment of penalties for filing false and fraudulent returns were based on opinions and not on facts, and the special investigation failed to bring out any facts on which to base such a recommendation. Therefore it is recommended that the returns of the taxpayer for the years prior to the year 1919 be accepted as originally made, that no penalties be assessed, and that additional tax for the year 1919 be assessed as follows:

1919, additional tax $5,333.28

The following is a comparative statement of the income for that year as originally returned and adjusted:

1919

	Return	Adjusted	Increase	Decrease
(A) Income from business:				
Gross sales	$1,485,385.16	$1,485,385.16		
Deductions—				
Cost of goods sold—				
Freight	21,612.85	21,612.85		
Commissions	3,751.66	3,751.66		
Merchandise bought	1,265,001.22	1,248,817.33		$16,183.89
Other costs	34,988.16	33,412.72		1,575.44
Opening inventory	36,375.00	36.375.00		
Total	1,361,728.89	1,343,969.56		
Closing inventory	36,375.00	36,375.00		
Net cost of goods sold	1,325,353.89	1,307,594.56		
Other business deductions—				
Salaries and wages	76,592.25	76,592.25		
Rent	1,547.54	1,483.09		64.45
Interest	1,175.46	1,175.46		
Taxes	1,599.65	1,599.65		
Repairs, wear and tear, etc	16,905.00	17,019.55	$114.55	
Insurance	5,296.76	5,225.24		71.52
Bad debts	14,673.06	14,673.06		
Other expenses	26,348.97	25,393.88		955.09
Total deductions	1,469,492.58	1,450,756.74		
Net income from business	15,892.58	34,628.42	18,735.84	

1919

	Return	Adjusted	Increase	Decrease
(B) Income from salary	$13,000.00	$15,133.82		$2,133.82
(H) Total income from above sources	28,892.58	49,762.24		
(I) General deductions:				
1. Interest		543.74	$543.74	
4. Contributions	1,558.10	997.35		560.75
Total	1,558.10	1,541.09		
(J) Net income subject to normal tax	27,334.48	48,221.15	20,886.67	
(K) Dividend		137.50	137.50	
(L) Net income subject to surtax	27,334.48	48,358.65	21,024.17	
Tax:				
Net income (item J)		48,221.15		
Personal exemption		2,000.00		
Balance		46,221.15		
Normal tax of 4 per cent on		−4,000.00	160.00	
Normal tax of 8 per cent on		42,221.15	3,377.69	
Surtax on (item L)		−48,358.65	5,132.49	
Total tax			8,670.18	
Original tax			3,336.90	
Additional tax			5,333.28	

Explanations of the differences follow:

Merchandise bought	$16,183.89
Other costs (truck expense)	317.42
Rent	64.45
Insurance	71.52
Other expenses	955.09
Donations	60.75
Total	17,653.12

This total is composed of items that were charged in the deductions in the return for the year 1918, and because of an adjustment entry on the books in the year 1919 were also included in the deductions in the return for the latter year.

Other costs	$1,575.44

This amount includes the following items which are capital expenditures:

1 tank	$400.00
Do	340.50
Cab for truck	130.00
Ford sedan	387.52
Total	1,258.02
Also an item of "Other costs" which is included in the preceding explanation of the amount $17,653.12	317.42
Total	1,575.44
Depreciation	114.55

This item represents additional depreciation allowed.

Salary	2,133.82

This amount is composed of the following personal items which are included in the business expenses and are therefore included as salary to adjust:

Contributions	1,558.10
Income tax, 1918	433.56
Withdrawals	142.16
Total	2,133.82

Contributions	$560.75
This item is composed of an amount of a contribution to a political campaign	500.00
Also an amount which is previously explained in the total $17,653.12	60.75
Total	560.75
Dividend	137.50

This represents the amount of dividends received from stockholdings.

The differences between the findings in the original investigation and the findings in the special investigation are explained as follows:

Gross sales and income $2,645.50

This item represents profits computed by the revenue agents on transactions where autotrucks were traded as part payment for new trucks. No profits arise from such transactions.

Truck expense and tank installation $12,964.57

This amount is composed of the following items:

Estimated amount of gasoline and oil used for operating trucks, etc.	$6,318.00
Cost of truck purchased in 1918	6,367.14
Work on boat *America*	279.43
Total	12,964.57

Exception is not taken to the disallowance by the revenue agents of the first item, but as the inventories are stated arbitrarily, and as the calculation of net income by the percentage method indicates that this is an equitable deduction, after consultation with the officials of the unit it has been allowed.

The second item represents the cost of a truck bought in 1918 and which the taxpayer claims was lost in 1919 by an accident in the mountains near Cumberland, Md. This statement was confirmed by employees. It is also noted that while the revenue agents claim the truck was bought in 1918, it is not shown in the list of trucks in the depreciation statement prepared by them.

The third item was for work on the boat which the taxpayer operated in the harbor of Baltimore. Vessel property has to be overhauled regularly, and for overhauling a boat of the size of the *Americo* the amount of the item would be small.

Closing inventory $29,668.51

The amount of the inventory used by the taxpayer in the return was estimated as at December 31, 1919; the amount of the inventory used by the revenue agents was taken from a financial statement made up by the taxpayer's son as at June 30, 1919.

If the use of the amount of the inventory is based on reason at all, the inventory as of December 31 should be used. The logic of this is that as the volume of business in the summer is greater than in the winter, an inventory taken in the former season would naturally be larger in amount than one taken in the latter season, and therefore it would not be fair to substitute the former for the latter. However, as the tax rates for the years 1919 and 1920 are the same, whichever inventory is used makes no difference in the amount of taxes ultimately collectible, except in the surtaxes, and these would be greater by using the amount of the closing inventory shown in the taxpayer's return for the year 1919.

Traveling expense $1,392.19

The revenue agents state that this amount can not be supported by vouchers. It is rare that the traveling expenses of an individual can be supported by vouchers. In considering the requirements of the business for an expenditure of this nature, the allowance of this item is considered equitable.

At a conference with one of the revenue agents who assisted in the original investigation, he stated that none of the disallowances had been taken up with the taxpayer.

J. C. Eckel,
Internal Revenue Auditor.
C. C. Dannaker,
Internal Revenue Auditor.

NOVEMBER 12, 1925.

In re Louis Blaustein, Baltimore, Md.
Memorandum to Mr. C. R. NASH,
Assistant to the Commissioner.

Reference is made to the criticism by the Senate committee relative to the manner in which the Bureau of Internal Revenue closed the case of Louis Blaustein, an individual residing in the city of Baltimore, Md., involving the taxable years 1913 to 1919, inclusive.

It appears that the principal allegation of error is that the Income Tax Unit disregarded a report prepared by internal revenue agents and also a report prepared by a special operative of the Intelligence Unit of the bureau, with the result that the taxpayer was relieved of the payment of additional taxes, exclusive of penalties, of approximately $42,000.

It appears that this taxpayer did not keep proper books of account and that the records available were incomplete and in most instances inaccurate. These facts, coupled with the taxpayer's extraordinary secretiveness regarding his business transactions, resulted in a most difficult situation with respect to the proper verification of the returns filed. After careful consideration of the statements made by the examining officers, together with those offered by the taxpayer, it was considered advisable to order a special investigation of such books and records as were available to reconcile the statements of both the taxpayer and the examining officers, and for that purpose two excellent auditors of the Income Tax Unit were ordered to examine the taxpayer's records. The examination resulted in the findings that hearsay or suspicion could not effectually form the basis for the computation of a tax, and the case was closed on the basis of the actual record.

After careful consideration of the facts in the case, I am constrained to view the closing proper and in accord with the law and regulations.

C. B. ALLEN,
Assistant Deputy Commissioner.

CARSON HILL GOLD MINES (INC.)

[By L. H. Parker, October 21, 1925]

Discovery; valuation not made within 30 days after discovery; ruling allowing, unpublished; taxpayer to whom allowed not discoverer.
To: L. C. Manson, general counsel.
From: L. H. Parker, chief engineer.
Taxpayer: Carson Hill Gold Mines (Inc.), Boston, Mass.
Subject: Discovery value of gold mines.

SYNOPSIS

From an examination of the record in the case of the Carson Hill Gold Mines (Inc.), Boston, Mass., the following points appear to be the most interesting:

1. The date of discovery of the original gold mine was prior to March 1, 1913.
2. The actual date on which a new and richer grade ore vein was discovered in the old mine was September 26, 1917.
3. As of September 26, 1917, an option to purchase this property was held by Mr. W. J. Loring.
4. The Carson Hill Gold Mines (Inc.) was incorporated November 22, 1917, and on November 28, 1917, they acquired the option held by Mr. W. J. Loring.
5. Carson Hills Co. did not actually acquire title to the property until December 28, 1918, on which date they paid the $600,000 in cash for same as specified in the option.
6. The bureau has allowed as date of discovery December 28, 1918.
7. From the above it appears that the bureau has allowed a discovery value on a new vein of ore in a mine which had already been discovered, it has allowed this discovery value to a company which was not formed until 57 days after date of discovery, and it has allowed this company a discovery value as of a date one year and three months after the real date of discovery in spite of the 30-day limitation contained in the law.

The history of this case is best shown by certain quotations from the official records of the bureau:

"During 1916, W. J. Loring and two associates, operating for convenience under the name of the Calaveras Consolidated Syndicate, had possession of a group of claims comprising the Calaveras property and adjoining the Morgan mine, and desired to add to that group the Morgan mine, believing that there was a possibility of finding a recurrence in depth of the ore bodies which had made the mine famous in the early days of gold mining in California.

"An agreement and option to purchase the Morgan mine was secured on November 10, 1916, by W. J. Loring, acting for himself and associates. The terms of the agreement and option of purchase provided for the exclusive possession of the property by the optionee for a period of three years, specified certain work to be done, none of which was in that portion of the mine in which the discovery was afterwards made, and bound the owner to deliver title to the property to the optionee at anytime during the life of the agreement and option on payment of the purchase price. The terms of the agreement and option offered two alternatives to the Morgan Mining Co. in the event the optionee exercised the right to purchase: It could accept either $600,000 cash or 40 per cent of the stock of a company to be incorporated for the purpose of taking over and operating the Morgan and Calaveras properties. This price was not based on the known value of the mine, but was subject to revision downward in accordance with whatever might be disclosed in development.

* * * * * * *

"That on September 25, 1917, chance exploratory work on the 300-foot level encountered high grade ore in a section of the Morgan property heretofore unexplored. That this encounter led to the "discovery" of the Morgan hanging wall ore body, allowance for depletion of which is the basis of this claim, and that this ore body was not connected in any way with any ore body previously known to exist in the Morgan mine, and further more that there are reasons for doubting even yet its connection with any ore body previously known in the Melones mine (adjoining).

"In the meantime, the Calaveras mine had reached the point where it was deemed advisable to commence milling the low grade ore developed in that property, and in order to place the holdings of Mr. Loring and associates on a sounder basis, on November 22, 1917, the Carson Hill Gold Mines (Inc.), with an authorized capital of $1,000,000 was organized in accordance with the plan of agreement and option on the Morgan mine, and on November 28, 1917, all assets of the syndicate were transferred to the corporation for $600,000 of its capital stock, the members of the syndicate receiving shares in proportion to their interest in the assets transferred. The balance of the capital stock amounting to 40 per cent was held to pay for the Morgan mine in case the company should elect to exercise its option and the Morgan Mining Co. desired payment in that manner.

"The agreement and option on the Morgan mine was included in the assets acquired by the corporation for stock and was valued at $12,989.71, which represented a nominal value of $1 for the option and $12,988.71 actually expended for development to November 28, 1917, the date of such acquisition.

* * * * * * *

"That from November 28, 1917, development work proceeded with the view of determining the extent and quality of the new ore body sufficiently to justify its purchase under the terms of the agreement and option, and on November 30, 1918, notice was given to the Morgan Mining Co. by the Carson Hill Gold Mines (Inc.), that it desired to exercise its option to purchase. The Morgan Mining Co. chose the alternative of selling for $600,000 cash, and on December 28, 1918, 28 days after notice of election to purchase, the Carson Hill Gold Mines (Inc.) acquired the title in fee to the Morgan mine by paying the purchase price specified in the option."

VALUATION BY UNIT

The following is the valuation report made by the unit allowing discovery value:

April 13, 1923.

Valuation report by metals section in re Carson Hill Gold Mines (Inc.), Boston, Mass.; valuation for depletion purposes based upon discovery value as of December 28, 1918

Depletion 1919, 1920, 1921, 1922.—The following valuation was made and accepted by the taxpayer in conference April 9, 1923:

For the purpose of this valuation only proven and probable ores as of December 28, 1918, within the high grade hanging wall Morgan ore body have been included, as it was this ore shoot which formed the basis of the taxpayer's claim for discovery.

Capitalized development during the prospecting period is included in the amount set up as capital recoverable through depletion in this memorandum so it is to be excluded from the capital recoverable through depreciation.

	Tons	Grade	Value
Estimated ore reserves at date of discovery (engineer's)	188,638	$17.28	$3,259,664.64
Add: For tonnage dilution, 20 per cent	37,728		
Adjusted ore reserves for valuation	226,366		3,259,664.64
Nonrecoverable values (8 per cent)			260,773.17
Estimated recoverable values	226,366		2,998,891.47
Estimated operating costs		4.66	1,054,865.56
Estimated profits			1,944,025.91

Deduct: Estimated plant and equipment expenditures from date of discovery:		
Mine plant and equipment	$33,577.57	
Hill changes and additions	12,650.00	
		$46,227.57
Estimated net mine profits		1,897,798.34
Deduct: Estimated eastern office administrative expenses, 4 years, at $10,000		40,000.00
Estimated net profit for valuation		1,857,798.34
Risk rate—10 per cent and 4 per cent—4 years (factor .745178).		
Present value of expected profits as of date of discovery		1,384,390.42
Deduct:		
Actual expenditures for mine plant and equipment at date of discovery	$26,466.29	
Total cost of mill $103,875.77		
Probable useful life of mill 10 years portion of mill capacity allocated to Morgan mine (4 years of the 10 years)	41,550.31	
Capitalized development prior to operations but subsequent to discovery	3,492.43	
Total deductions for necessary capital expenditures prior to operations		71,519.03
Present value of ores only as at date of discovery		1,312,871.39
Add: Capitalized development from Dec. 28, 1918, to date property placed on operating basis		3,492.43
Total value recoverable through depletion as at date operations commenced, 1919		1,316,363.82
Ounces of gold in reserves at date of discovery ($20.67) $3,259,664.64		157,700.27
Total costs of mine and development Dec. 28, 1918		635,517.35

Depletion rate per ounce of gold, $8.347251.

Depletion charge based on value allowed

[Rate per ounce as per separate statement, $8.347251]

Year	Gross production from high-grade ore body	Ounces gold	Depletion allowable
1919	$1,091,714.06	52,816.36	$440,871.41
1920	1,116,766.10	54,028.35	450,988.20
1921	752,468.69	36,404.87	303,880.59
1922	346,724.24	14,450.69	120,623.62
Total	3,307,673.09	157,700.27	1,316,363.82

BALANCE RECOVERABLE THROUGH DEPLETION

The loss claimed for the year 1920 of $11,991.38 by reason of expenditures for development spent upon the Adelaide claim, which was abandoned during the year is allowable as a loss. This claim has been substantiated by affidavit of Mr. W. J. Loring, which is filed with the case.

Inasmuch as capitalized development has been included in the capital recoverable through depletion, and as expenditures for development have been carried as depreciable assets by the taxpayer, it is recommended that the depreciation allowance be computed upon basis of physical life, as shown in the schedule accompanying this memorandum.

———— ————,
Assistant Valuation Engineer.

Approved:

———— ————,
Chief, Metals Valuation Section.

UNPUBLISHED RULING OF SOLICITOR

The Solicitor of Internal Revenue has issued the following unpublished ruling covering the pertinent points of this case:

OCTOBER 8, 1923.

In re Carson Hill Gold Mines (Inc.),Boston, Mass.

Deputy Commissioner BRIGHT
(For the Engineering Division):

Reference is made to your memorandum of April 21, 1923, in which you ask the opinion of this office on certain questions relating to the tax liability of the above-named taxpayer.

No oral hearing was had, but the taxpayer on July 24, 1923, filed a brief on the questions involved.

It appears that some time prior to November 10, 1916, the Calaveras Consolidated Syndicate, under the management of Mr. W. J. Loring , had acquired a group of mining claims. Contiguous to those claims was the Morgan mine, the property of the Morgan Mining Co., the bulk of whose stock was owned by Mrs. W. K. Vanderbilt. Under date of November 10, 1916, Mr. Loring secured an option on the Morgan mine in his own name, although he was presumably acting for the Calaveras Syndicate. Under the terms of the agreement Mr. Loring was given possession of the property for three years, with the obligation to perform a certain specified amount of development work and with the privilege of purchasing the property at an agreed price at any time within the option period.

The Calaveras Syndicate performed the development work, but up to September 26, 1917, had encountered no ore bodies of commercial grade. During the interval between September 26, 1917, and November 28, 1917, work was performed on a new high-grade ore body, but sufficient work was not done during this period to prove an ore reserve sufficient to add a new mine to those previously known to exist.

On November 28, 1917, the Carson Hill Gold Mines (Inc.) was organized under the laws of the State of Maine, with a capital stock of $1,000,000. The option on the Morgan mine was taken over by the Carson Hill Co. for a nominal consideration of $1 plus the amount which had been expended for development of the mine.

From November 28, 1917, to December 28, 1918, the Carson Hill Gold Mines (Inc.) developed the high-grade ore shoot as rapidly as possible, and it was during this period that a new mine was discovered. On November 30, 1918, the taxpayer, as the successor of W. J. Loring and the Calaveras Syndicate, exercised the option to purchase the mine, and on December 28, 1918, the consideration was paid and title passed. Under the terms of the option, Mrs. Vanderbilt had the alternative of accepting $600,000 in cash or 40 per cent of the stock of a company to be formed to operate the mine. She chose to accept cash, and the sale was made on that basis.

Section 214 (a) (10) of the 1918 act, in so far as material, reads as follows:

"In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted. *Provided,* That in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date: *Provided further*, That in the case of mines, oil and gas wells, discovered by the taxpayer, on or after March 1, 1913, and not acquired as the result of purchase of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost, the depletion allowance shall be based upon the fair market value of the property at the date of the discovery, or within thirty days thereafter; such reasonable allowance in all the above cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary."

Article 219 of Regulations 45 provides that "The discovery must add a new mine to those previously known to exist and can not be made within a proven tract or lease as defined in paragraph (f) infra." The unit has, in effect, found that the old Morgan mine was abandoned, as under then economic conditions it could not be profitably operated, and that there has been a discovery by the taxpayer herein of a new mine within the meaning of the law and the regulations.

The question then arises, Did the taxpayer have such an interest in the mineral deposit as to entitle it to the benefit of the discovery clause contained in section 214 supra? It will be noted that the statute provides for depletion on properties acquired prior to March 1, 1913, on the basis of the fair market value of the property "or the taxpayer's interest therein" on that date. These words, "taxpayer's interest therein," are not repeated in connection with the latter part of the section with regard to discovery, but the reading of the whole section indicates that the clear intention was that deductions based on discovery, as well as the ordinary depletion deduction, were to be settled with reference to the taxpayer's interest in the property and were not dependent upon absolute ownership. In the instant case the taxpayer was in possession of the property operating the same; its possession was exclusive and no other person or corporation had a right to operate the property; the taxpayer had a right to demand a deed to the property, and a right to enforce this demand by a bill in equity for specific performance, until the demand for a deed should be made, the net proceeds of the ore removed were placed in escrow under the agreement, which provided that in case the taxpayer exercised its election and purchased the property, and the seller elected to take pay in stock of the corporation, these net proceeds should be paid over to the taxpayer, or if the seller elected to take pay in cash the net proceeds should be applied on the purchase price.

You ask to be advised whether the taxpayer during his tenure, prior to purchase in fee simple on December 28, 1918, was a licensee or a lessee. It would seem clear that the rights granted the optionee under the agreement were not those of a mere licensee. Whether the rights granted were sufficient to give the taxpayer the status of a lessee, as that term is defined in the law, it is not believed necessary to here decide, suffice to say it did have such an interest in the property as to entitle it to the depletion allowance granted by the statute including depreciation based on discovery.

It will be noted from the provisions of the statute quoted above that the taxpayer is barred from discovery value if the property was acquired as the result of the purchase of a proven tract. In the instant case on the date legal title to the property passed on to the Carson Hill Co. the property was a proven tract, but on the date that the option agreement was acquired by the taxpayer and he took possession the property was not a proven tract. In this case the agreement was made and the purchase price fixed prior to the time that the taxpayer went into possession and prior to the date that it made the discovery. By the terms of the agreement all work done by the taxpayer was, in case he exercised his option, to belong to him and all ore mined during this period which had been sold and placed in escrow was to become his property. The exercise of the option in this case was in effect to give to the taxpayer all of the elements of beneficial ownership as of the date the agreement was made. Under these peculiar facts it is not believed that it can be said that the exercise of the option followed by the passing of legal title constituted the purchase of a proven tract within the meaning of section 214 (a) (10). It is therefore the opinion of this office that it is a case of a mine discovered by the taxpayer and not acquired as the result of purchase of a proven tract.

The file is returned with the suggestion that the tax liability of this company be adjusted on the basis here set forth.

NELSON T. HARTSON,
Solicitor of Internal Revenue.

DISCUSSION OF CASE

We desire to make the following criticism of this case:

In the first place, the Morgan mine was an old mine operated long before March 1, 1913. It had contained much high-grade ore and, in fact, was famous in the early days for the richness of such ore. In 1913, or shortly subsequent thereto, the mine had apparently run out of high-grade ore and contained only ore that was too low in grade to be profitably mined. The fact that some of the high-grade ore was missed in the original operation of this property does not, to our minds, allow of a subsequent value being set up upon the finding later on of some more of this high-grade ore. The law provides for discovery valuations in case of mines or oil and gas wells discovered by the taxpayer after March 1, 1913. It does not appear to us that the law intended allowing a mine to be discovered twice. This mine was a gold mine. It was discovered before March 1, 1913, and we contend that no subsequent discovery should be allowed in this same mine.

In the second place, if a discovery could be allowed on the disclosure of a new vein in this mine, the date of such discovery should have been September 26, 1917, when this high-grade ore was first encountered. A valuation under the law could have been made as of this date, or within 30 days thereafter, namely, October 26, 1917. We believe that Congress had a definite purpose in putting into the law the clause: "As of date of discovery or 30 days thereafter." It appears to us that they meant the first sudden increment in value, as apparent on the date of discovery, or 30 days thereafter, should be allowed and that increment only. The bureau has allowed a year and three months from this date of discovery as the date of valuation for depletion purposes. If they can allow a year and three months to explore property, in direct opposition to the 30-day law, there is no reason why they should not allow 10 years or more to elapse before valuing a property.

In the third place, the discovery value has been allowed a company which not only did not make the discovery as required by law, but was not even in existence on the date of this discovery. The data previously presented shows that the date of discovery was September 26, 1917, and the taxpayer company was not organized until November 22, 1917. The option to purchase was not acquired by the taxpayer until November 28, 1917, at which date considerable development work had already been done.

In the fourth place, while we disagree, as shown above, with the conclusions reached, we believe that the ruling allowing discovery valuation in this case is so fundamental in its principles, that it certainly should have been published, for the information of all taxpayers. There is absolutely nothing in the published rulings to show that a taxpayer is entitled to a valuation one year and three months after date of discovery, when the actual discovery was not made by the taxpayer at all.

CONCLUSION

We conclude in this case, as in the sulphur cases, that the bureau has put a ridiculous construction upon the discovery clause of the law. It would appear that they may be aware that their interpretation of the discovery clause is not according to the intention of the law, and that this is probably the reason why they refrain from publishing the ruling in this case. The requirement of the act for a valuation within 30 days after date of discovery is completely disregarded.

Respectfully submitted.

L. H. Parker,
Chief Engineer.

Celite Products Co.

[By L. H. Parker, May 26, 1925]

May 26, 1925.

Depletion; improper allowance of; Mr. Briggs's separation from service.

To: Mr. L. C. Manson, general counsel.
From: Mr. L. H. Parker, chief engineer.
Subject: Transmittal of Celite Products Co.

There is transmitted herewith, in triplicate, the case of the Celite Products Co. You will note that this case brings out again the fact that Mr. J. H. Briggs has protested, both verbally and in writing, against the obviously incorrect valuations made in the nonmetals section.

In view of the fact that Mr. Briggs has been an important aid to us in our work by giving frank answers to our questions, I would like to make one more effort to bring before the members of the committee and the representatives of the bureau, additional facts which will establish Mr. Briggs's value to the Government.

It appears to the writer that by the dismissal of Mr. Briggs the bureau is putting subserviency, blind obedience, and cowardice before honesty, frankness, and fearlessness.

We do not believe that gentlemen of such high character as Mr. Blair and Mr. Nash would do this if they fully understood the facts. Anything that you can do in this matter will be appreciated, as the discharge of Mr. Briggs has had a serious moral effect on the personnel of the bureau. The individuals of the Income Tax Unit regard Mr. Briggs's discharge as being a result of too many protests, and, of course, the tendency will be to govern their actions accordingly.

I would also suggest that Mr. Briggs be called as a witness in the Celite Products case, as there is a statement therein which is based on verbal information secured from him on this matter.

Respectfully submitted.

L. H. Parker,
Chief Engineer.

May 26, 1925.

Office memorandum No. 15.
To: L. C. Manson, general counsel.
From: L. H. Parker, chief engineer.
Taxpayer: Celite Products Co., Los Angeles, Calif.
Subject: Depletion, nonmetals.

FIGURES INVOLVED

Purchase price, February, 1912 (in stock)	$325, 000
Invested capital allowed	325, 000
Value allowed as of Mar. 1, 1913	1, 550, 000

SYNOPSIS OF CASE

It appears from the record of this case—

First, that the taxpayer has been allowed a value for invested capital purposes based on the par value of stock issued in exchange for the property, with absolutely no evidence being submitted that the market or cash value of this property at date of acquisition was anywhere near equal to the par value of the stock.

Second, that the taxpayer has been allowed a valuation as of March 1, 1913, five times the above amount allowed at date of acquisition, although only one year had elapsed since the date of acquisition, and nothing had taken place in the meantime to substantiate any such rise in value.

Third, that the March 1, 1913, value has been based on an average tonnage mined of 70,000 tons annually, although the actual tonnage mined in 1912 was about 3,000 tons; in 1913, 5,000 tons; in 1914, 10,000 tons; and in 1919, 12,000 tons.

HISTORY OF CASE

It appears the taxpayer was disallowed all depletion on June 1, 1920. The taxpayer protested this allowance and came in for a conference on April 20, 1922. (See Exhibit B, attached.) The taxpayer was claiming depletion on a deposit of diatomaceous earth located in California which he had acquired in 1912 for $325,000 par value stock. The following statement was made in the conference:

"General discussion in regard to establishing a March 1, 1913, value greater than cost as represented by stock issued for property and representative informed that with available evidence at hand there seems to be no possible way of establishing a greater value either by replacement or by discounting earnings. Representative's attention was called to the fact that the company had practically no net income until 1917 and very small in that year and on the 1918 return submitted by the taxpayer he had estimated a value of the capital stock at 37 cents on a dollar which would agree with the valuation determined by this office on the deposit owned by the taxpayer."

On May 12 and 13 another conference was held. (See Exhibit C, attached.) In this conference the taxpayer was granted a valuation at date of acquisition in

1912 for invested capital purposes of $325,000. He was also granted a March 1, value of $1,550,000 and a depletion rate of 86 cents per ton.

The value of $325,000 is fixed at the par value of the stock paid for the property. There is absolutely nothing in the files showing that this was the actual cash value of the property.

For the March 1, 1913, valuation of $1,550,000, the appraisal of the American Appraisal Co. was used. (See Exhibit D, attached.) This appraisal is based on a tonnage mined of 70,000 tons and a profit of $2 per ton which equals an annual profit of $140,000. This amount discounted at 8 per cent for a period of 40 years would be about $1,550,000.

The depletion set up by the American Appraisal Co. was changed slightly by the bureau's valuation report dated May 25, 1922. (See Exhibit E, attached.) However, the valuation itself is not changed. We are also attaching, under Exhibit F, a statement from the taxpayer from which we will wish to quote in our discussion.

DISCUSSION OF THE CASE

Section 326 of the revenue act of 1918 provides that for invested capital the following may be included: "(2) Actual cash value of tangible property, other than cash, bona fide paid in for stock or shares, at the time of such payment, but in no case to exceed the par value of the original stock or shares specifically issued therefor."

We submit that the par value of stock issued in such cases is simply mentioned in the law as a limit, but that the intent of the law is to require a determination of the actual cash value of property paid for by stock at the time of payment. We can find absolutely nothing in the records of this case to show that any attempt was made to determine the actual cash value of this property. The taxpayer was allowed the full par value of stock amounting to $325,000.

In regard to the March 1, 1913, value of $1,550,000, there is nothing to show why any such extraordinary rise in value took place. Inasmuch as only one year had passed since the year of acquisition, we believe that this alone would have been sufficient grounds for denying the taxpayer a right to the March 1, 1913, value. In order however, to show in what a ridiculous manner the analytic appraisal method has been applied in this case, we will grant for the moment the right of the taxpayer to set up a March 1, 1913, value.

In the first place, a profit of $2 per ton has been used. There is absolutely no substantiation of this rate of profit. Practically no profit was realized by this company until 1917. (See Exhibit B.) We certainly would think that some definite data in regard to selling prices and operating costs as of March 1, 1913, should have been required.

In the second place, the valuation is based on an annual tonnage to be mined of 70,000 tons. As an actual fact, only 50,000 tons was mined from 1912 to 1916, or an average tonnage of about 12,000 tons yearly. Even at $2 a ton, this would cut the annual expected profit from $140,000 to $24,000, which would, of course, make an enormous difference in the valuation. There are several other features of this case which show utter disregard of engineering principles, but we will not go into them in detail. The examination of the exhibits, however, will show that the quantity of material available was greatly in excess of that used in the valuation, a rate of 8 per cent was used on a new industry, the future of which could not be accurately predicted, and that depletion was based on tonnage mined instead of tonnage sold, when it is admitted that 25 per cent of the tonnage is placed in storage dumps.

We believe that we have stated enough to condemn the practices shown in this determination. Moreover, it was known to engineers in the bureau that this determination was erroneous. Mr. C. C. Griggs, chief of the nonmetals section, and now assistant head of the engineering division, approved of the valuation in this case, and when Mr. J. H. Briggs, valuation engineer, who had attended the conference, refused to sign the conference memorandum allowing this valuation, he was told by Mr. Griggs that "he could go to h——."

CONCLUSION

This case, following as it does numerous other cases along the same lines, shows that it is a common practice in the engineering division to disregard the requirements of the law and the principles of engineering. It again shows that verbal as well as written protests are of no avail.

Respectfully submitted.

L. H PARKER,
Chief Engineer.

EXHIBIT B

TAXPAYER'S CONFERENCE,
NATURAL RESOURCES DIVISION, NONMETALS SECTION,
April 20, 1922.

Taxpayer: Celite Products Co.
Address: Los Angeles, Calif.
Represented by: Mr. F. W. Jackson, American Appraisal Co., Milwaukee, Wis.

Matter presented.—Taxpayer's representative called to state that valuation given taxpayer as par value of stock at acquisition in 1912 in lieu of a much larger valuation claimed as at March 1, 1913, was not acceptable to taxpayer.

General discussion in regard to establishing a March 1, 1913, value greater than cost, as represented by stock issued for property, and representative informed that with available evidence at hand there seems to be no possible way of establishing a greater value either by replacement or by discounting earnings. Representative's attention was called to the fact that the company had practically no net income until 1917, and very small in that year, and on the 1918 return submitted by taxpayer he had estimated a value of the capital stock at 37 cents on a dollar, which would agree with the valuation determined by this office on the deposit owned by taxpayer.

Representative requested a conference on May 10, 1922, at which time the president of the company will be present, and time was extended until after that date for case to be sent to audit.

Interviewed by—

C. C. GRIGGS, *Chief.*
S. L. SHONTS, *Valuation Engineer.*
J. H. BRIGGS, *Valuation Engineer.*

Approved:

C. C. GRIGGS,
Chief, Nonmetals Valuation Section.

EXHIBIT C

TAXPAYERS CONFERENCE,
NATURAL RESOURCES DIVISION, NONMETALS SECTION,
May 12, 13, 1922.

Taxpayer: Celite Products Co.
Address: 624 Van Nuys Building, Los Angeles, Calif.
Represented by: Mr. Fitger, vice president and treasurer and Mr. F. W. Jackson, of American Appraisal Co.

Matter presented.—Valuation of property and the rate of depletion as at acquisition and as at March 1, 1913. Taxpayer acquired property in February, 1912, for $325,000 par value of stock and claimed March 1, 1913, valuation as determined by the American Appraisal Co. of $1,550,000. Paid-in surplus not claimed. The increase in value between acquisition and March 1, 1913, was claimed on account of the wide general use developed for the product which resulted in contracts showing an expected earning of not less than $5 per ton. Contracts were submitted which called for a large production but had no provision for increase in selling price due to increase in operating expenses. The small earnings shown by the company in subsequent years was explained from the fact that due to war conditions, labor and operating costs were so high (and under terms of the contracts the selling price remained the same) that the property continued operating with a small profit and in some years with a financial loss.

After due consideration and considering all evidence submitted, taxpayer's claims were acknowledged and it was agreed to accept the March 1, 1913, valuation of $1,550,000 as established by the American Appraisal Co. in appraisal dated January 21, 1920, and the tonnage estimated at 1,750,000 tons giving a depletion value of $0.86 per ton. Valuation accepted for acquisition for invested capital $325,000. Sustained depletion to be at the rate of 18 cents.

Attention is called to the fact that both sustained and allowed depletion is on the basis of tonnage mined and not on tonnage sold. The amount of depletion deducted on income tax returns would be the same but inasmuch as an amount in excess of 25 per cent is culled from the product mined and placed in storage dumps, the value of these dumps can not be capitalized at any future time, nor can depletion be claimed upon them.

Interviewed by—

A. H. Fay, *Head Natural Resources.*
J. H. Briggs, *Valuation Engineer.*
C. C. Griggs, *Chief of Section.*
W. H. Gibbs, *Auditor.*

Accepted for the taxpayer:

Arnold K. Fitger, *Vice President and Treasurer.*

Approved:

C. C. Griggs, *Chief, Nonmetals Valuation Section.*

Approved for audit May 17, 1922. Fay.

Exhibit D

The American Appraisal Co.,
Milwaukee, May 9, 1922.

CELITE PRODUCTS CO

Depletion.—As a tentative method of arriving at what might be considered a fair rate of depletion to be claimed under the internal revenue act, we might consider what would be the value of this property to an owner who was willing to permit of its operation under royalty agreements.

The Hollister estate, which owns a similar deposit in the vicinity, refused an offer of a royalty of $1 per ton, and stated that they might be willing to consider $2.50 per ton.

In 1920 the production from the property of the Celite Products Co was 68,000 tons and the actual sale about 58,000 tons. There is, therefore, every indication that an ultimate output of 70,000 tons per annum, which was expected in 1913, was reasonable. Therefore, taking as a basis an output of 70,000 tons per year, the value of the property to the owner who was willing to sublet it on a royalty basis could reasonably have been computed as follows: 70,000 tons per year at $2 per ton would represent an annual payment of $140,000.

Appreciating the fact that the volume of the deposit in place is in excess of the amount which could be reasonably expected to be depleted within the period for which investments are generally made, we assume that an investment of this nature should be returnable in 40 years, and that inasmuch as the royalty owner would not be assuming the hazards of exploitation, a fair rate of return would be 8 per cent.

The present value of $140,000 per year for a period of 40 years at 8 per cent would be approximately $1,550,000.

During this period the quantity of the material taken out would be 70,000 multiplied by 40 equals 2,800,000 tons.

The unit rate of depletion would then be $1,550,000 divided by 2,800,000, which would be equivalent to a unit rate of depletion of about 55 cents per ton.

We quite appreciate that this method of arriving at a depletion unit is based upon conditions existing at the present time and present known facts which were not known in their entirety in 1913. This method of establishing values, however, so closely approximates the value established under the conditions which the buyers of this property foresaw in 1913 that we believe it would be worthy of serious consideration and it is submitted accordingly.

LIFE OF DEPOSITS

Seventy thousand sales total estimated average per year:

$$\frac{25 \text{ years}}{1,750,000} = \text{25-year total sales.}$$

Based on knowledge of past and future sales, the following proportion would obtain:

Fifty thousand Filter-Cel. sales annually:

$$\frac{25 \text{ years}}{1,250,000} = \text{Total Filter-Cel. sales in 25 years.}$$

Twenty thousand Sil-O-Cel sales annually:

$$\frac{25 \text{ years}}{500,000} = \text{Total Sil-O-Cel sales annually.}$$

About 1,000,000 tons of Filter-Cel material available at this time according to estimate of Mr. E. B. Starr our engineer.

Balance of material on the property is Sil-O-Cel grade.

Working life of property largely limited by deposits of Filter-Cel materials as it is not practical to produce and market Sil-O-Cel except through organization justified by Filter-Cel sales. This limits commercial life of deposits to 25 years.

Summary of material quarried based upon tonnage of products sold, 1912 to 1919, inclusive

	Crude	Ground	Brick	Sundry	Total
Sales—Tons:					
1912	3,054				3,054
1913	1,283	2,319	294		3,896
1914	2,588	5,272	344		8,204
1915	2,252	7,643	292		10,187
1916	4,284	9,462	1,712	430	15,888
1917	4,259	13,479	5,507	251	23,496
1918	5,955	21,980	6,576	821	35,282
1919	1,664	29,032	7,145	669	38,510
Total	25,339	89,137	21,870	2,171	138,517
Material quarried—Tons:					
1912	3,054				3,054
1913	1 283	2,899	735		4,917
1914	2,588	6,590	860		10,038
1915	2,252	9,554	730		12,536
1916	4,284	11,827	4,280	430	20,821
1917	4,259	16,849	13,768	251	35,127
1918	5,955	27,412	16,440	821	50,628
1919	1,664	36,290	17,862	669	56,485
Total	25,339	111,421	54,675	2,171	193,606

Tonnage of material available in deposit at date acquired	1,550,000
Fair market value, Mar. 1, 1913	$1,550,000
Depletion per ton of material quarried	$1

Exhibit E

SECTION OF INORGANIC NONMETALS—QUARRYING AND MILLING CELITE

May 25, 1922.

Case reviewed by John Seward, valuation engineer, June 1, 1920, who disallowed all depletion at that time.

Reference is made to taxpayer's conference May 12 and 13, 1922, represented by Mr. Fitger, vice president and treasurer, and Mr. F. W. Jackson, of the American Appraisal Co.

Taxpayer purchased 2,215 acres of land in the Santa Znes Mountains, near Lompoc, Calif., June 3, 1912, on which a deposit of diatomaceous earth occurs, certain city lots in the town of Lompoc, buildings, machinery, equipment, and a stock of raw material. Property was acquired for $325,000 in stock, par value, and taxpayer claimed a March 1, 1913, value of $1,550,000, as determined by the American Appraisal Co. The increase in value between acquisition and March 1, 1913, was claimed on account of the wide general use developed for the product which resulted in contracts showing an expected earning of not less than $5 per ton.

ACTION TAKEN

Valuation at acquisition, February, 1912:

Claimed: Mineral land, $325,000. Allowed: $325,000 as mineral land subject to depletion.

Valuation as at March 1, 1913:

Claimed: Mineral land, $1,550,000. Allowed: $1,550,000 as mineral land subject to depletion.

Valuation at January 1, 1914.

Valuation at January 1, 1917: Allowed: $325,365.22. Depletion, $315,754.12.

Sustained.—Taxpayer estimated 1,750,000 tons of diatomaceous earth, available at acquisition, which with a cost $325,000 gives a unit value of 18 cents per ton, which is approved as the rate of sustained depletion.

Allowed.—An estimated available tonnage of 1,750,000 tons of diatomaceous earth with an appraised value of $1,550,000 gives a unit value of $0.886 per ton, which is approved as the rate of allowed depletion.

Attention is called to the fact that both sustained and allowed depletion is on the basis of tonnage mined and not on tonnage sold. The amount deducted on income-tax returns would be the same, but as an amount in excess of 25 per cent is called from the mined product and put in storage dumps, this product can not be capitalized or further depletion claimed on it.

Notice is also called to the fact that the depletion allowed bears a low ratio to the gross sales from 1912 to 1920, inclusive, and a still lower percentage to the gross sales for the year 1920:

Total gross sales, 1912 to 1920, inclusive	$4, 649, 107. 35
Total allowed depletion on basis of $0.886 per ton mined equal 5 per cent of gross sales.	
Gross sales, 1920	1, 830, 863. 85
Allowed depletion for 1920 at $0.886 per ton mined equal 3 per cent.	

The reason the allowable depletion ratio to the gross sales shows a decrease for the year 1920 is because in 1920 the contracts under which the company were held expired, and these contracts made in pre-war times obligated selling often at a loss, hence the higher ratio of allowable depletion to the gross sales. On expiration of these contracts, taxpayer increased his selling price, had increased gross sales for a similar tonnage sold in prior years, thereby reducing the percentage of allowable depletion to the gross sales.

Valuation memorandum dated June 1, 1920, is superseded by action of this date.

Years	Tons	Depletion claimed	Depletion sustained on on cost at $0.18 per ton	Depletion allowed on Mar. 1, 1913, valued at $0.886 per ton
Prior to 1913	3, 054	$3, 054. 00	$549. 72	
1913	4, 917	4, 917. 00	885. 06	$4, 356. 46
1914	10, 038	10, 038. 00	1, 806. 84	8, 893. 668
1915	12, 536	12, 536. 00	2, 256. 48	11, 106. 896
1916	20, 821	20, 821. 00	3, 747. 78	18, 447. 406
1917	35, 127	35, 127. 00	6, 322. 86	31, 122. 522
1918	50, 628	50, 628. 00	9, 113. 04	44, 856. 408
1919	56, 485	56, 485. 00	10, 167. 30	50, 045. 710
1920	68, 553	68, 553. 00	12, 339. 54	60, 737. 958
Total	262, 553	262, 159. 00	47, 188. 62	229, 567. 03

W. W. HANSON,
Assistant Valuation Engineer.

Approved: Chief nonmetals valuation section.

EXHIBIT F

Questions relating to valuation and depletion unit for diatomaceous earth deposits located at Lompoc, Calif.

1. *Capital stock valuation shown in 1919 capital stock tax return.*—Management of company was reorganized in 1920 and capital stock valuation has subsequently been properly prepared. Accounting practices in earlier years resulted in improper practices. Company now requesting permission to file amended returns for years 1918 and 1919.

2. *Operating loss for period to January 1, 1920.*—Company originally had program of selling raw deposit which would have resulted in profit of about $5 a ton. The possibilities of development of increased use of product were foreseen and original policy abandoned in 1912 to carry forward development of extended uses requiring large experimental and advertising expense. Long-period contracts

entered into 1914 to 1918 at low selling price resulted in excessive losses during subsequent years when cost of operation had materially increased due to war conditions. Small operating capital required excessive expenditures for materials in order to maintain credit. It is estimated that during period to January 1, 1920, development expenditures amounted to approximately $600,000 and that additional losses due to long-period contracts experimental charges and limited operating capital resulted in approximately $1,200,000 loss.

3. *Anticipated deduction of 70,000 tons per annum.*—The company operated during 1919 at approximately 60,000-ton production, and it is estimated that 70,000 average for period of 25 years from 1913 is most conservative.

4. *Asking price of Telford property.*—This is substantiated by memorandum from Mr. A. H. Kreiger, written about March 1, 1913, and a copy of a letter from Miss Telford to Dr. D. S. Collins, offering her property for sale, this letter being dated 1912.

5. *Increase in value between February, 1912, and March 1, 1913.*—The Magna-Silica Co. had operated property for some 10 years prior to 1912, but were unappreciative of its value, and lacked working capital necessary to place product upon the market. Sale was consummated at practically receivership prices due to financial conditions of prior organization. Prior organization had developed market for small amount of material used for pipe covering and building insulation and limited market for filter purposes in beet-sugar industry. New organization immediately employed experts to develop market as substantiated by copies of reports and correspondence, together with extract from Metallurgical and Chemical Magazine of February, 1914, entitled "The Kieselguhr Industry."

6. *The effect of geographical location on properties.*—Location of deposit has distinct climatic advantages due to open-air drying of product and is easily accessible to both shipping and land transportation. More than 50 per cent of tonnage is used by sugar industries for filter purposes, all of the cane-sugar refineries being located at tidewater. Celite Products Co. furnish either brick or raw material for all high-temperature insulating brick used to this time in this country, so that freight to consumer is not a competitive factor.

The above notes are covered in detail in a letter from Mr. R. J. Wig, vice president of the Celite Products Co., addressed to the American Appraisal Co., under date of May 3, which letter is supplemented by copies of the original correspondence, reports, and other information used to substantiate position taken by taxpayers.

Inheritance Taxes

[By F. B. Potter, September 18, 1925]

Deduction of State inheritance taxes and Federal estate taxes from income for income tax purposes

September 18, 1925.

Mr. L. C. Manson,
Counsel Senate Committee for Investigation,
Bureau of Internal Revenue.

REPORT IN RE DEDUCTION OF STATE INHERITANCE TAXES AND FEDERAL ESTATE TAXES FROM INCOME FOR INCOME TAX PURPOSES

The principal questions involved under the above title may be presented best by a statement of two typical cases handled by the Bureau of Internal Revenue.

Certificate of overassessment No. 297871, in the sum of $717,796.64, was issued to the New York Trust Co., executor, estate of William L. Harkness, New York, N. Y., for income taxes paid for 1920. The reason given in such certificate is:

"An examination discloses that net income of $1,197,656.80 was reported, but the deduction of Federal estate tax amounting to $7,729,395.32 eliminates the entire taxable income."

Certificate of overassessment No. 233253, in the sum of $253,465.48, was issued to Miss Isabelle W. Tilford, Orange County, N. Y., for 1920 income tax paid.

The adjustment producing the overassessment was the deduction from the income of the beneficiary of State inheritance tax paid by the estate, as shown by the following quotation from the certificate:

"Inasmuch as your proportionate share of the $877,671.48 inheritance taxes is in excess of your income, there is no taxable income on your return."

It will be noted from the foregoing that Federal, estate tax paid was deducted from the income of the estate of the deceased while State inheritance tax paid was deducted from the income of the legatee or beneficiary derived from other sources.

This is the general rule used by the bureau, except that the inheritance tax paid to four States—Maryland, Utah, Rhode Island, and Pennsylvania—is not deducted from the income of the legatee or beneficiary, but is deducted from the income of the estate in the same manner as the Federal estate tax.

The statute provides that estate and inheritance tax paid shall be allowed as a deduction, but leaves the question open as to whose income it shall be so allowed. The bureau has attempted to determine the latter question with the result shown above.

The revenue act of 1924, section 214 (a), provides that—

"In computing net income there shall be allowed as deductions: * * * (3) taxes paid or accrued within the taxable year * * *."

It is clear that the legislative intent was to include estate and inheritance tax under this clause because a similar provision in a prior act had been so interpreted by the Supreme Court before the enactment of the 1924 act. But the statute being silent, inquiry must be made into the nature of the tax in question in order to determine whether the deduction should be allowed to the estate, the beneficiary, or either.

No warrant is found in the statute above quoted for treating Federal estate taxes and State inheritance taxes differently, nor for a different treatment of the inheritance taxes paid to some States from those paid to other States. A study of the nature of all these taxes reveals no differences which can justify such different treatment.

All these laws, collectively known as death duties, are based upon the theory that there is no right to transmit or to inherit property title to which terminates by death, except such right as the statute creates, and that the sovereign may give a right to transmit and receive all or any portion of such property; that the statutes of devolution, descent, and wills are modified by the tax statute so that the right to transmit or receive is fixed at the instant of death; that there is no right to inherit until death occurs, and that such right is never increased nor diminished after its creation.

The sole reason given by the bureau for making a distinction and the only rule employed is this: If the tax is upon the right to transmit, it is deductible from the estate; if it is upon the right to receive, it is deductible from the income of the beneficiary.

Article 134, Regulations 65, reads in part as follows:

"Estate, succession, legacy, or inheritance taxes, imposed by any State, Territory, or possession of the United States, or foreign country, are deductible by the estate, subject to the provisions of section 214, where, by the laws of the jurisdiction exacting them, they are imposed upon the right or privilege to transmit rather than upon the right or privilege of the heir, devisee, legatee, or distributee to receive or to succeed to the property of the decedent passing to him. Where such taxes are imposed upon the right or privilege of the heir, devisee, legatee, or distributee, so to receive or to succeed to the property, they constitute, subject to the provisions of section 214, an allowable deduction from his gross income."

That this is the sole rule employed is the general opinion of students of the subject. In the introduction to Prentice-Hall tax service, 1924–25, the following appears:

"The theory of the inheritance tax is complicated. * * * It may be a tax upon the right to receive property, or upon the right to transmit property. The decisions are conflicting and inconclusive on this point. The matter is, however, of more than academic importance by reason of the present provision under the Federal income tax law allowing the amount of tax paid as a deductible item when it is imposed on the right to receive."

There are two distinct errors involved in the use of this rule. The first is the erroneous assumption that the tax is imposed upon the right to receive. It is legally impossible that this be true, for the tax statute and the statute of descent are on the same plane; both together form one law and both jointly give the beneficiary such right as he ever has. The beneficiary finally receives everything from the estate to which he is or was ever entitled. A "right" is the power to obtain the help of the State in the accomplishment of a desired end. The State by its courts will aid the beneficiary to obtain only that which he finally does obtain. He never receives nor has a right to receive the share taken by the State. The same is true as to the right to transmit.

The second error is due to the purely logical fallacy of making an objective classification based upon a subjective difference. Transmission and receipt as used herein are subjective interpretations of the same occurrence. The transfer of property by descent is instantaneous. The right of the State attaches instantaneously and the instant is the same for both. An obstruction to such transfer can not be imposed upon the transmission without being imposed upon the receipt in precisely the same degree.

Therefore, since the death duty is not imposed upon any right, and since it can not be an imposition upon transmission or receipt separately, the basis for the different treatment accorded these taxes disappears.

It is submitted that the conclusion just reached will appeal to a thorough student of the question, will avoid the fallacies found in the many "conflicting and inconclusive" decisions, and is justified by authority as well as theory. In Knowlton v. Moore (178 U. S. 55) Chief Justice White, after an exhaustive study of the nature and history of death duties, says:

"Thus, looking over the whole field, and considering death duties, in the order in which we have reviewed them, that is, in the Roman and ancient law, in that of modern France, Germany, and other continental countries, in England and those of her colonies where such laws have been enacted, in the legislation of the United States and the several States of the Union, the following appears: Although different modes of assessing such duties prevail and although they have different accidental names, such as probate duties, stamp duties, taxes on the transaction, or the act of passing of an estate or a succession, legacy taxes, estate taxes or privilege taxes, nevertheless tax laws of this nature in all countries rest in their essence upon the principle that death is the generating source from which the particular taxing power takes its being and that it is the power to transmit or the transmission from the dead to the living on which such taxes are more immediately rested."

This case held that such taxes were indirect.

With the view, then, that all such taxes should be treated alike so far as concerns the place upon which their burden is rested, the next question is who should be allowed the deduction.

In U. S. v. Perkins (163 U. S. 625) the question was whether property bequeathed to the United States could be included in a succession tax imposed by a State. It was decided that it could be.

Since the State of New York could have no power to tax the United States, the beneficiary in this case, the tax was necessarily held not to have been placed upon the legatee. Hence the legatee, not being taxed, should not be allowed to deduct the payment from his income.

This appears to be sound as the language of the court, "it is not until it has yielded its contribution to the State that it becomes the property of the legatee."

In Plummer v. Coler (178 U. S. 115) the question was whether under the inheritance tax laws of New York a tax could be placed upon a legacy consisting of United States bonds issued under a statute declaring them exempt from State taxation in any form. It was held that the tax was proper.

This case holds that the tax is not placed upon the property for a State can not tax a United States bond. This appears to be authoritative and absolutely sound. But there is a result which follows by ineluctable logic from this position. The tax is not upon the property and the property is the estate, for the estate is the aggregate of the property left by the decedent and is that only. Hence the tax is not upon the estate and the tax should not be deducted from the income thereof.

That the tax is not placed upon the decedent seems self-evident, since the decedent does not exist when the tax is imposed.

The confusion found in the cases appears to be more apparent than real. The expressions "right to transmit," "transmission," and "right to receive" are used interchangeably; the decisions as to where the tax falls need not be affected by substitution of one for the other.

Perhaps the nearest approach to an exact statement of the subject taxed is found in Matter of the Estate of Swift (137 N. Y. 77), in which the court said that the "effect of this special tax is to take from the property a portion or percentage of it for the use of the State, and I think it quite immaterial whether the tax can be precisely classified with a taxation of property or not. It is not a tax on persons."

The foregoing considerations are sufficient for the exclusion of death duties from deductions allowed for income-tax purposes, but, since a change in the revenue act will be necessary to accomplish such exclusion, a further study of the nature of death duties and the theory of their imposition may be found useful as a basis for corrective legislation.

We have found that the death duty is not a tax on persons, and is not a tax on property and that its burden is not imposed upon anyone. This forces us to the conclusion that it is not a tax in the ordinary sense at all or that it is fundamentally different from all other taxes. The death duty, however, has been termed a tax and is so generally known as such that for convenience it is best described as a tax sui generis differing fundamentally from all other taxes.

It operates and has the same effect as if the State were made a joint heir or codistributee of the property or credits left by a decedent. This view is consistent with all decisions, though not with the language found therein, except the decisions holding death duties were intended to be included in the revenue act above set forth whereby "taxes paid" are allowed as deductions. It is conceded that this construction is correct as to the legislative intent. But despite the fact that Congress meant to include death duties paid among allowable deductions it was nevertheless error on the part of the administrative authority to allow the deduction to persons upon whom such death duties were not in reality imposed. The maze of conflicting court decisions, both Federal and State, will prevent any rational uniform correction by any power except Congress.

The need for this reform is demonstrated by the following illustrations.

In Johnson *v.* Keith (291 Fed. 964) the question was whether the New York transfer tax, a death duty was deductible from the income of the estate for Federal income tax purposes. It was held that it was so deductible on the ground that it was imposed upon the estate and that the estate rather than the beneficiaries paid the tax. The reasoning of the court was to the effect (1) that there were none except two entities upon whom the tax could be imposed, namely, the estate and the beneficiary; (2) that it was not imposed upon the beneficiary (3), therefore, it was imposed upon the estate. This reasoning is so purely syllogistic in form that the fallacy is striking, namely, that both premises are negative in violation of the elementary rule in logic that from two negative premises no valid conclusion can be drawn. In order that the conclusion be valid it must be assumed that the tax is imposed upon one of the two entities; but in U. S. *v.* Perkins, supra, it was held that the tax was not imposed upon the beneficiary, the beneficiary in that case being the United States, and in Plummer *v.* Coler, supra, it was held not to be imposed upon the estate, the estate being United States bonds. All three decisions relate to the New York death duty which was the same except for minor changes not referred to in the decisions. The Bureau of Internal Revenue conflicts with all three of these cases in its allowance of the New York death duty as a deduction from the income of the beneficiary on the ground that the tax is imposed upon him. Such tortuous ramblings do not adorn the genius of the present age.

To further illustrate the confusion, attention is called again to the present Income Tax Regulations 65, which provides in part as follows:

"When, in accordance with a direction contained in the testator's will, the taxes upon the right to receive any particular devise or devises, legacy, or legacies, are so payable as to relieve the particular devisee or devisees, legatee, or legatees, from the burden thereof, then the persons entitled to the fund or other property out of which payment is made may not take deduction of the taxes so paid, but deduction thereof is available only to such devisee or devisees, legatee or legatees; each, if there be more than one, being authorized to deduct such part of the taxes so paid as he would otherwise have been entitled to do had there been no such testamentary direction."

Applying this provision, suppose A dies leaving $200,000 and by his will bequeaths $100,000 to X and states that all the State death duty shall be paid out of the other $100,000, whereupon the remainder shall go to Y. The bureau would allow X to deduct the death duty from his income and would not allow the deduction to Y. Such absurdity is painful.

It is clear that Y should not be allowed the deduction; he was given by the will a sum equal to the difference between the death duty and $100,000; he received that sum unimpaired. But the same is true of X.

Having shown that the allowance of death duties in all its forms as a deduction from income is not based upon any sound legal theory, let it be tested by general consideration of policy.

Inheritance of property is not in any way related to income. It is an accidental capital gain not included in income because not "derived from capital, labor, or property."

Suppose A and B are partners and derive $100,000 each from the business. In a given year a relative of A bequeaths him $100,000. There is no reason in fairness or equality for relieving A of his Federal income tax for that year.

It is therefore submitted that section 214 (a) (3) of the revenue act of 1924 be amended as follows: The last sentence, which reads, "For the purpose of this paragraph, estate, inheritance, legacy, and succession taxes accrue on the due date thereof except as otherwise provided by the law of the jurisdiction imposing such taxes," should be changed to read, "For the purpose of this paragraph, death duties, estate, inheritance, legacy, and succession taxes, paid to the United States, a State, a Territory, a possession, or a foreign government, shall not be allowed as deductions."

Respectfully submitted.

F. B. POTTER.

ARTHUR R. LEWIS

[By Geo. G. Box, July 29, 1925]

Sale of capital assets

JULY 29, 1925.

In re Arthur R. Lewis, New York, N. Y.

This taxpayer was engaged in the shipping industry, with offices at 39 Cortlandt Street, New York, N. Y. In rendering his income-tax return for the year 1917, he attached thereto a statement reporting a profit of $2,149,086.12 which he had received from the sale of certain ships. This amount, however, was not included in his gross income for the reason that he had been advised by counsel that income derived from the sale of capital assets was not subject to income tax. Subsequently, in the year 1920, he utilized the profits made from the 1917 transaction in the purchase of other vessels.

An examination of the taxpayer's books and records for the years from 1917 to 1920 was made by a revenue agent, and as a result of an office audit based thereon, an A-2 letter was mailed to the taxpayer under date of December 2, 1922, proposing an additional assessment in the amount of $1,546,341.03.

The taxpayer protested to the additional assessment and applied for relief under section 214 (a) (12) of the revenue act of 1921, and article 263 of Regulations 621, which are as follows:

"SEC. 214 (a). That in computing net income there shall be allowed as deductions: (12) If property is compulsorily or involuntarily converted into cash or its equivalent as a result of (a) its destruction in whole or in part, (b) theft or seizure, or (c) an exercise of the power of requisition or condemnation, or the threat or imminence thereof; and if the taxpayer proceeds forthwith in good faith, under regulations prescribed by the commissioner with the approval of the Secretary, to expend the proceeds of such conversion in the acquisition of other property of a character similar or related in service or use to the property so converted, or in the acquisition of 80 per cent or more of the stock or shares of a corporation owning such other property, or in the establishment of a replacement fund, then there shall be allowed as a deduction such portion of the gain derived as the portion of the proceeds so expended bears to the entire proceeds. The provisions of this paragraph prescribing the conditions under which a deduction may be taken in respect of the proceeds or gains derived from the compulsory or involuntary conversion of property into cash or its equivalent shall apply so far as may be practicable to the exemption or exclusion of such proceeds or gains from gross income under prior income, war profits, and excess-profits tax acts.

"ARTICLE 263, Regulations 62. *Replacement of funds.*—In any case where the taxpayer elects to replace or restore the converted property, but where it is not practicable to do so immediately, he may obtain permission to establish a replacement fund in his accounts in which part or all of the compensation so received shall be held, without deduction for the payment of any mortgage, and pending the disposition thereof the deduction shall be tentatively allowed. In such a case the taxpayer should make application to the commissioner on Form 1114 for permission to establish such a replacement fund and in his application shall recite all the facts relating to the transaction and undertake that he will proceed as expeditiously as possible to replace or restore such property. The taxpayer will be required to furnish a bond with such surety as the commissioner may require for an amount not less than the estimated additional income and war-profits and excess-profits taxes assessable by the United States upon the income so carried to the replacement fund. (See section 1329 of the statute.) The estimated additional taxes, for the amount of which the claimant is required to furnish security, should be computed at the rates at which the claimant would have been obliged to pay, taking into consideration the remainder of his net income and resolving against him all matters in dispute affecting the amount of the tax. Only surety companies holding certificates of authority from the Secretary of the Treasury as acceptable sureties on Federal bonds will be approved as sureties. The application should be executed in triplicate, so that the ommissioner, the applicant, and the surety or depositary may each have a copy "

There is nothing in the record to show that the converting of the ships into cash was compulsory or involuntary as a result of their destruction, theft, or seizure, or that there was imminence or threat of their requisition or condemnation, nor did the taxpayer forthwith expend the proceeds of the sale in the acquisition of other property of a similar character, no as required by article 263 of Regulations 62 did he apply tothe Commissionr of Internal Revenue for permission to establish a replacement fund.

The Bureau of Internal Revenue denied the benefit of section 214 (a) (12) of the revenue act of 1921 to the taxpayer.

The taxpayer stated that he was unable to pay the additional taxes above mentioned and that any effort to collect such amount from him would force him into bankruptcy. To substantiate this statement he submitted to the bureau a statement of his resources which aggregated $287,914.92. He submitted an offer in compromise in the sum of $310,000 in lieu of his tax liability to the Government for the years in question in the amount of $1,546,341.03 under date of January 31, 1923.

After the receipt by the bureau of this offer, Auditor E. C. Algire and Revenue Agent D. A. Judge, of the Internal Revenue Bureau, were instructed to make a special investigation of the assets of taxpayer. Their report, which was submitted under date of February 26, 1923 (Exhibit A), shows the total estimated realizable value of taxpayer's assets at $337,914.92. Acting on this report the Solicitor of Internal Revenue under date of May 7, 1923, recommended to the commissioner that in his opinion it would be proper and to the best interests of the United States to accept the $310,000 proposed by taxpayer as a compromise offer in lieu of all the tax liability of this taxpayer for the years in question.

Under date of June 1, 1922, Revenue Agent Max Michelman submitted a report to the supervising internal revenue agent at New York of an examination made by him of this taxpayer. (Exhibit B.) In this report the agent states, among other things, as follows:

"In a visit to the taxpayer on May 29, 1922, examining officers were informed by Mr. Lewis that his estimate of cash on deposit to the credit of his account in the different banks was about $500,000 and that he held about $50,000 in stocks and bonds.

"Investigation of taxpayer's bank balances showed at Corn Exchange Bank, Terminal Branch, New York, about $300,000. In attempting to secure additional information as to his financial status the agencies of R. G. Dun & Co. and Bradstreets were visited, where examination of their files showed that taxpayer had never given them a statement of assets and liabilities.

Taxpayer owns all of the capital stock of Seas Shipping Co., which had a book value as of Jan. 1, 1922	$2, 275, 600. 50
Also has 5,919 shares of American & Cuban Steamship Line, par value	591, 900. 00
Also has 1,225 shares in the Overseas Shipping Co., par value	122, 500. 00
Cash in Corn Exchange Bank	300, 000. 00
Stocks and bonds (per own statements)	50, 000. 00
Total estimated net worth	3, 340, 000. 50

"On the basis of the above present-day financial condition of the taxpayer it would seem that Mr. Lewis has sufficient capital to pay the additional tax found due in its entirety."

In regard to the value of the capital stock of Seas Shipping Co. owned by taxpayer, attention is invited to the fact that Messrs. Algire and Judge failed to show that this stock is an asset. They state that—

"The books of this company were available, but owing to the method of bookkeeping employed, each voyage being kept separate and no closing having been made for the year, it was impossible to obtain a statement. However, an inspection of the books indicates that a substantial profit for the past year has been earned. The nature of this business is very peculiar in that the amount of business done depends solely upon Mr. Lewis's ability to get business. Therefore, while this appears to be a highly profitable business, if Mr. Lewis was no longer connected with the company it is not likely that the stock would have any market value."

The last sentence of this statement is so ridiculous that it should be given no consideration whatsoever.

The report of Michelman shows that on January 1, 1922, the capital stock of this concern showed a book value of $2,275,600.50. The statement of Messrs. Algire and Judge shows that while they were unable to obtain a statement showing profit and loss for the year 1923, yet a substantial profit was made for the year 1922, so that the book value at the end of 1922 was probably greater than at the beginning of that year. This book value necessarily was based on actual assets, and regardless of the nature of the business or whether or not the success of it depended on Mr. Lewis's ability to obtain business, it had nothing whatsoever to do with the value of the assets at the time the examination was made, and had the business been sold the purchase price would have depended upon the assets of the company and not upon the ability of the taxpayer to obtain future business.

Messrs. Algire and Judge state in regard to the East Coast Coaling Co. that it is capitalized at $100,000 and the taxpayer owns 224 shares at a par value of $22,400, that the company has a surplus of $51,736.60, that it had an operating loss for the year 1922 of $10,599.93, and that "Mr. Lewis states that if the company is to continue operations an assessment will have to be made on the stockholders." For this reason they state that in their opinion the stock in this company has no market value. In other words, we have here a company capitalized at $100,000 with a surplus of $51,736.60, a book value of over $151 per share, but these agents overlooking this fact report that the stock has no market value because the taxpayer informs them that if the company continues operations an assessment will have to be made on the stockholders.

In regard to the Atlantic Coast Shipping Co. of Massachusetts, Overseas Shipping Co. of New York, and American & Cuban Steamship Line of New York, the agents state that their success depends almost entirely on the efforts of the taxpayer, and if his connection with the company was severed it is doubtful if the stock would have any market value whatsoever.

This is certainly a novel argument for the determination of the market value of stock in a going concern. Following this line of reasoning the capital stock of a corporation which had cash assets of $10,000 if controlled by Mr. Lewis would have no book value if he sold his interests and thereby terminated his connection with the company which would tend to influence its future business.

It is interesting to note, that at the time Revenue Agent Michelman made his report, taxpayer's own estimate of cash on deposit to his credit in different banks was about $500,000, but that nine month later, when Messrs. Algire and Judge submitted their report, they state that "cash in bank, as shown by taxpayer, fluctuates and remains about the same, $3,114.92."

It is also noted that the notes held by taxpayer of the American & Cuban Steamship Co., secured by mortgages on three 4,000 dead-weight ton lake type steamers, with a face value of $450,000, are estimated to have a value of $150,000.

From the estimate of $30 per ton dead-weight by Mr. Lewis as the value of the vessels of the Seas Shipping Co., referred to in this report, it would appear that these vessels had a value of at least $360,000 instead of the $150,000 estimated by Messrs. Algire and Judge.

From the discrepancies which appear on the face of the report of these employees, especially in view of the fact that the bureau had the report of Agent Michelman in its files, and that there was such a large discrepancy between the resources of this taxpayer as shown in these two reports, it is inconceivable that the solicitor would accept the latter report as a basis on which to make a recommendation of the acceptance of the offer in compromise without having a thorough investigation made of the taxpayer's books and records from 1920 up to the then present time with a view of ascertaining his actual financial condition, which most certainly was not shown by the report of Messrs. Algire and Judge.

GEORGE G. BOX, *Chief Auditor.*

TREASURY DEPARTMENT,
Washington, October 30, 1925.

Hon. JAMES COUZENS,
Chairman Senate Investigating Committee.

DEAR MR. CHAIRMAN: Reference is made to the report submitted by the representative of the investigating committee with reference to the case of Arthur R. Lewis, New York, N. Y. In this report the representative of the committee criticizes the action of the Bureau of Internal Revenue in accepting $310,000 in compromise of additional taxes of $1,546,341.03 due from the taxpayer.

For the purpose of considering the compromise the additional tax liability appears to have been accepted as sound. The offer appears to have been accepted because of the apparent insolvency of the taxpayer. After the offer was made Mr. Lewis's financial condition was investigated by Mr. E. C. Algire, an auditor for the Income Tax Unit, and Mr. D. A. Judge, internal revenue agent. These men both recommended the acceptance of the offer and their recommendation was approved by Mr. L. C. Wilmer, supervising internal revenue agent at New York and Mr. Frank K. Bowers, collector of internal revenue for the second district of New York.

The criticisms by the committee's agent are based largely upon statements made in a report under date of June 1, 1922, submitted by Revenue Agents Max Michelman and Joseph M. Jablons. This report was made more than six months prior to the submission of the compromise offer. The taxpayer in connection with his offer submitted a statement showing his financial resources and this as well as the report of Agent Michelman above referred to were in the hands of Auditor Algire and Agent Judge at the time they made their investigation.

The taxpayer's statement, shows realizable assets of $287,814.92 and in addition stocks in several corporations. Messrs. Algire and Judge gave $377,914.92 as the total estimated realizable value of the assets. This is an increase of $90,000 over the taxpayer's statement, which is made up by assigning to stock owned by Mr. Lewis in a corporation known as the Thirty-Nine Courtland Street Corporation a value of $75,000, and by increasing by $15,000 the value of a mortgage owned by Mr. Lewis on certain steamers belonging to the American & Cuban Steamship Co.

The criticism by the committee's agent is directed primarily at the apparent failure of the bureau to regard certain stocks owned by the taxpayer as having substantial value for purposes of a compromise. The names of these corporations are:

East Coast Coaling Co. (Inc.).
Atlantic Coast Shipping Co. of Massachusetts.
Overseas Shipping Co. of New York.
Atlantic Coast Shipping Co. of Maryland.
American & Cuban Steamship Line of New York.
Seas Shipping Co. (Inc.) of New York.

With regard to the stock of the East Coast Coaling Co. the taxpayer holds 224 out of 1,000 shares. The business of the company is loading bunker coal into steamers. Messrs. Algire and Judge submitted with their report a statement of the assets and liabilities of the company, showing capital stock $100,000, and net assets $151,736.60, of which $17,834.39 is cash and the balance chiefly machinery, gears, etc. The taxpayer states that on account of the coal strike in this company in 1922 and the then high price of bunker coal in the United States, steamers which the company formerly coaled were then being coaled for the round trip in Europe. The Government agents submitted a profit and loss statement for 1922 showing a net loss of $19,599.93. Inasmuch as the business in which the company was engaged was then badly demoralized and its assets consisted almost entirely of small machinery, gears, and the like, the value of which upon forced sale would unquestionably be nominal, it would appear that the bureau was amply justified in regarding the value of this stock as being nominal.

The Atlantic Coast Shipping Co. of Massachusetts had a capital stock of $50,000 of which Mr. Lewis owned one-half. It did a general stevedoring business in Boston. Its assets consisted of ordinary gears such as rope slings, crowbars, and other like machinery for loading and discharging ships. Its physical assets, like those of the East Coast Coaling Co., were of only nominal value for purposes of a forced sale, hence its stock could not have had more than a nominal value.

The Overseas Shipping Co. of New York had a capital stock of $250,000 of which Mr. Lewis owned 1,200 shares. This company does a general stevedoring business in New York Harbor. It owned, according to the taxpayer, gear for loading and discharging ships, two tugboats, a truck and automobiles used in connection with the work. Its physical assets likewise would have no considerable value on forced sale.

The Atlantic Coast Shipping Co. of Maryland had a capital stock of $100,000, of which Mr. Lewis owned 450 shares. It did a general stevedoring business outside of New York and Boston. Its assets according to the taxpayer consisted of stevedoring gear, hoists, a truck and several work automobiles and a warehouse in Habana, Cuba, subject to a mortgage of $280,000. Its assets would also be of comparatively little value on a forced sale.

The taxpayer states with reference to these stevedoring companies, and Messrs. Algire and Judge concur, that stocks in the companies would be of very little value if Mr. Lewis severed his connections with the companies inasmuch as his activities are responsible for practically all of their business. The companies were engaged in rendering of a personal service and since the assets of the companies had no considerable sale value, the value of the stock depended primarily upon the ability of the management to get the business, and disassociated from the man whose activities were the chief source of their business the stocks would not have brought much on a forced sale. It appears, therefore, that both Mr. Lewis and the agents were correct in their conclusion.

With reference to Mr. Lewis' stock in the American & Cuban Steamship Line or New York, Agent Michelman in his report states that the taxpayer owned 5,919 shares of a par value of $591,900. He does not, however, give any information as to the actual value of the shares. The taxpayer states, and his statement was verified by Messrs. Algire and Judge, that while this amount of stock stood in his name on the books of the company he actually owned only 1,545 shares. According to the taxpayer this company operates freight steamers between New York and Habana. Its chief assets are three 4,000-ton freight steamers which are subject to a mortgage of $450,000 held by Mr. Lewis. The agents investigated the value of these steamers and found it to be approximately $150,000. The mortgage is listed by the Government agents among the taxpayer's assets totaling $377,914.92. The agent submitted a statement of the company's assets and liabilities as of January 31, 1923, which shows gross assets $1,232,916.55, the largest item of which is steamships, $887,184.01, which is cost. The capital stock of the company is $750,000 of which the taxpayer owned approximately one-third. Reducing gross assets by the amount of the difference between the cost and current market price of the steamers, the gross assets of the company become $495,732.54. The liabilities of the company, exclusive of capital stock, are shown to be $482,916.55. The net worth of the company on this basis would be approximately $13,000. It would therefore appear that the bureau was wholly justified in regarding this stock as having no substantial value.

This leaves for consideration the stock in the Seas Shipbuilding Co. (Inc.), New York, which is the chief basis for the criticisms by the committee's agent. It had capital stock outstanding of $2,064,800, all owned by Mr. Lewis. The taxpayer states that it was organized in 1920 to take over four 10,000-ton American steamers which he had purchased from private owners for $4,872,000. According to both taxpayer and the Government agents, these vessels were the company's chief assets. In January, 1923, they were subject to a mortgage of $2,150,000. Their actual market value as of that date is given by the taxpayer at $30 per ton, or $1,200,000. As a result of their investigation the agents state that this valuation is in excess of their real market value. Their estimate is based upon a statement from a disinterested party having knowledge of ship values at that time. The bureau appears to have been amply justified in assuming this stock to have no substantial value.

Revenue Agent Michelman states in his report that at the time of his examination Mr. Lewis estimated his cash on hand and in bank at approximately $500,000 and that he investigated the taxpayer's bank balance at the Corn Exchange Bank, New York, and found it to be about $300,000. The taxpayer in his statement accompanying his compromise offer gives his cash on hand as $3,114.92, which figure Messrs. Algire and Judge state to be approximately correct. The committee's agent criticizes what he considers the carelessness of the bureau in accepting the statement of Messrs. Algire and Judge with reference to the taxpayer's cash on hand in view of the showing made in Agent Michelman's report. That report was before them, however, when the investigation was made and there is no reason for assuming that they did not make every effort possible to verify Mr. Lewis's bank deposits and cash on hand as of that date. It must be remembered that over six months elapsed between the date of Agent Michelman's report and the date of the report of Messrs. Algire and Judge; that Mr. Lewis was in active business on a large scale and it is entirely reasonable that he might have had $500,000 on hand in June, 1922, and practically no cash six months later, especially since he was engaged on a large scale in a business (the ship business) which at that time was a thoroughly demoralized due to the termination of the war and the slump in our foreign trade.

In considering this compromise offer the bureau was confronted with the practical question of whether it should accept the $310,000 submitted, which it should be noted was borrowed by the taxpayer, or whether it could realize more by forcing the sale of all the taxpayer's assets. The acceptance of the offer was recommended by the two agents of the bureau who personally made the examination of the taxpayer's affairs and by the supervising internal revenue agent and the collector of internal revenue at New York. The offer was then approved by the Solicitor of Internal Revenue, the Commissioner of Internal Revenue, and the Secretary of the Treasury. It would seem that these officials who after thorough consideration concluded that the acceptance of the offer was for the best interest of the Government were in a better position to pass judgment on this question than is the agent of the committee who has examined the file and expressed his judgment on the question presented some three years after the case was closed.

Sincerely yours,

D. H. Blair, *Commissioner.*

Lucky Tiger Combination Gold Mining Co.

[By Geo. G. Box, July 9, 1925]

EXEMPTION OF DIVIDENDS FROM FOREIGN CORPORATIONS

To: Mr. L. C. Manson, general counsel.
From: Geo. G. Box, chief auditor.
Subject: Lucky Tiger Combination-Gold Mining Co., Kansas City, Mo.

Herewith is the report of the Lucky Tiger Combination-Gold Mining Co. The defect in the 1918 law which exempted from taxation all the dividends received from a foreign corporation providing the latter had any taxable income from sources within the United States regardless of how small, has been remedied in the 1921 and 1924 acts by limiting the deductions allowed from gross income as regards dividends from foreign corporations to dividends in cases where it is shown to the satisfaction of the commissioner that more than 50 per centum of the gross income of the foreign corporation for the three-year period ending with the close of its taxable year preceding the declaration of such dividends, was derived from sources within the United States (sec. 234 (a) (6) of each act).

Geo. G. Box,
Chief Auditor.

In re: Lucky Tiger Combination Gold Mining Co., Kansas City, Mo.

This corporation was organized March 16, 1903 under the laws of the State of Arizona with an authorized capital stock of $650,000, 65,000 shares at a par value of $10 each. These shares were issued in exchange for cash and other tangible assets.

On May 21, 1909 the capital stock was increased to $8,000,000, 800,000 shares at a par value of $10 each. At the same time a stock dividend of 1,000 per cent was declared, and 650,000 shares of stock issued to the then present stockholders as a result thereof. In submitting its returns the taxpayer claimed $6,500,000 representing the par value of this stock dividend as invested capital for the purpose of computing excess profits taxes for the years in question.

On July 31, 1911, 337 shares of the stock were issued to redeem bonds of the corporation at the par value of $3,370 outstanding at that time.

The purpose for which the taxpayer was formed was to operate mining property in Mexico. However, as the laws of that country prohibited a foreign corporation from owning or operating a mine within 60 miles of the international border where the company's property was located, it was necessary to form a Mexican corporation. Accordingly the El Tigre Mining Co. was organized under the laws of Mexico by the taxpayer and the entire capital stock of the former was owned by this taxpayer.

An appraisal was made of the property of the El Tigre Mining Co. en bloc as of January 1, 1909, and a basis of valuation of $4,000,000 was established and accepted by the Commissioner of Internal Revenue as evidenced by his letter of March 5, 1912. A depreciation rate of $6 per ton was established, it being agreed that upon the recovery of the $4,000,000 to the investors, further claims should cease regardless of further discoveries. On the basis of the above agreement the taxpayer claimed as deductions for depletion the following amounts:

1917	$354, 372. 00
1918	548, 755. 51
1919	548, 973. 93
1920	472, 587. 00

The taxpayer received from the El Tigre Mining Co. during the years in question dividends, which is practically the only source of income of the holding company, in the following amounts:

1917	$396, 246. 50
1918	900, 000. 00
1919	900, 000. 00
1920	900, 000. 00

The amounts of these dividends were included by the taxpayer as gross income for the years in question, from which were deducted the amounts claimed for depletion mentioned above.

The El Tigre Mining Co. claimed that during the years 1918, 1919, and 1920 it received certain income from sources within the United States in the nature of receipts on account of the sale of surplus power to consumers in Douglas, Ariz.

When the Income Tax Unit audited the returns of the taxpayer for the years from 1917 to 1920, inclusive, the question arose whether any of the dividends received by it from its operating company in Mexico were taxable under the revenue acts of 1917 and 1918, in view of its claim of receiving income from sources within the United States. The amount of the dividends received and the amount of income from sources within this country for the years in question was immaterial as regards the tax liability of the taxpayer on these dividends in view of the decision rendered by the Advisory Tax Board in its Memorandum No. 21 (C. B. 1, p. 160), in which the board held that "any amount, however la.ge, received as dividends from a corporation taxable upon income from sources within the United States, however small such income may be, is exempt from the normal tax under section 216 (a) or, in case the recipient is a corporation under section 234 (a) (6)."

Subsequently an investigation by the Income Tax Unit of its records failed to disclose that any income had been received by the El Tigre Mining Co. from sources within the United States as claimed during the years in question.

In other words if the El Tigre Mining Co. received income from sources within the United States of $1,000 all of the dividends received from that corporation by this taxpayer, which amounted to $900,000 for each of the years 1918, 1919, and 1920 would be exempt from normal tax under the revenue act of 1918.

The Income Tax Unit submitted to the committee on appeals and review three questions in regard to the income of this taxpayer, as follows:

"1. Whether the compromise arrangement effected by the commissioner's letter of March 15, 1912, is binding through the years of the operation of the taxpayer.

"2. Whether the foregoing compromise is binding upon the taxpayer during such period and also under the several laws subsequently enacted.

"3. Whether the amounts making up the depletion reserve of the operating company, assuming it might set up such a reserve, may be deemed to have been included in the dividends received by the taxpayer and to that extent made up of nontaxable return of capital; or whether the total amount of dividends received by the holding company is deemed to be income taxable under the several laws."

Under date of November 21, 1921, the committee on appeals and review in its Memorandum No. 153 (C. B. I-1, p. 179) (Exhibit A) decided as follows: "It is held in the case of the Lucky Tiger Combination Gold Mining Co., of Kansas City, Mo., that the total amount of dividends received by this company as the holder of all the capital stock of the El Tigre Mining Co, S. A. of Mexico, for the years 1909-1919, inclusive, is income under the acts of August 5, 1909, October 3, 1913, September 8, 1916, October 3, 1917, and February 24, 1919, and no deduction therefrom for depletion by reason of the exhaustion of the ore body of the El Tigre Mining Co. is allowed; and that any purported compromise entered into by the Commissioner of Internal Revenue with the Lucky Tiger Combination Gold Mining Co. permitting such deduction, was without authority of law and of no effect."

Under date of April 20, 1922, the taxpayer submitted a claim for refund of $109,040.96 on account of overpayment of income taxes for the years from 1917 to 1920, inclusive. The taxpayer contended that the dividends received by it from the El Tigre Mining Co., a foreign corporation, were tax exempt under section 4 of the revenue act of 1917 and section 234 (a) (6) of the revenue act of 1918, in view of the fact that the El Tigre Mining Co. paid taxes (to the United States Government) under the revenue acts of 1917 and 1918 upon income from sources within the United States.

On October 30, 1922, a conference was held at which Mr. B. M. Price, of the solicitor's office, Mr. W. R. King, chief of auditing section F, and Mr. L. B. McArthur, auditor in section F, were present, and it was decided that dividends received from the El Tigre Mining Co. by the taxpayer for the years 1917 to 1920, inclusive, represented income exempt from normal tax. As a result of this conference an A 2 letter was sent to the taxpayer under date of October 31, 1922, showing the following:

Year	Deficiency	Overassessment
1917	$5,413.06	
1918		$41,760.44
1919		32,675.36
1920		44,009.53
Total	5,413.06	118,445.33

The original tax paid by the taxpayer for these years was as follows:

1917	$6,887.21
1918	52,979.45
1919	43,879.26
1920	44,009.53

Under date of November 4, 1922, the report made by a revenue agent in the field for the year 1917, proposed the assessment of additional taxes in the sum of $112,061.66, this additional tax being the result of the elimination by the revenue agent from invested capital of the $6,500,000 representing the par value of the stock issued as a stock dividend by the company when it increased its capitalization and the disallowance of depletion claimed by the taxpayer from gross income for that year under the agreement of the Commissioner of Internal Revenue allowing a depletion rate of $6 per ton, referred to above.

Under date of October 25, 1923, a report by the revenue agent of his investigation of the taxpayer's books and records for the years 1919 and 1920, proposed an additional overassessment of $5,859.19 for 1919. This overassessment was the result of his allowance of the deduction from gross income of the total amount of dividends received by taxpayer from the El Tigre Mining Co. He indicated, however, in his report, that he was unable to establish the fact that any income was actually received by the El Tigre Mining Co. from sources in the United States as claimed by it.

On November 20, 1924, Deputy Commissioner of Internal Revenue J. G. Bright submitted the case to the Solicitor of Internal Revenue for his consideration and opinion as to whether the dividends received by the taxpayer from the Mexican corporation were income taxable under the revenue acts of the United States. Under date of January 19, 1925, the solicitor rendered his decision (Exhibit B), in which he held, after a résumé of the laws affecting the taxation of dividends received from a foreign corporation, as follows:

"In the absence of evidence showing that the El Tigre Mining Co. actually derived income from sources within the United States during the years 1918, 1919, and 1920, it must be concluded in view of the foregoing, that the dividends in question are subject to tax. If it can be clearly established that the El Tigre Mining Co. actually received income from sources within this country, under the principle of L. O. 1054 and T. B. M. 21, supra, the dividends of the corporation in the hands of the recipient under the revenue act of 1918 are nontaxable."

As a result of the above decision a reaudit was made in the Income Tax Unit for the year 1919, and on March 14, 1925, an A-2 letter was mailed to taxpayer advising it of a proposed assessment for that year of $358,275.37. In the computation arriving at this assessment the dividends received were considered as income, the amount claimed as a deduction for depletion was disallowed, and the $6,500,000 representing the stock dividend above referred to was eliminated from the invested capital claimed by taxpayer.

At the time of the rendition of the solicitor's opinion above mentioned, the statute of limitation had barred the assessment and collection of taxes for the years 1917 and 1918. Over three years had elapsed between the date of the decision reached by the committee on appeals and review (Memorandum 153, above referred to) and the date of solicitor's decision (Exhibit B) during which time the taxes for the years 1917 and 1918 should have been recomputed, assessed, and collected.

Through the bureau's failure to settle the tax liability of this taxpayer for the years 1917 and 1918 in accordance with the decision of the committee on appeals and review (Memorandum 153) the Government has lost upward of $500,000 in taxes for those years as a result of the running of the statute of limitations.

GEO. G. BOX,
Chief Auditor.

EXHIBIT A

MEMORANDUM NO. 153, COMMITTEE ON APPEALS AND REVIEW

Held, in the case of the Lucky Tiger Combination Gold Mining Co. of Kansas City, Mo., that the total amount of dividends received by this company as the holder of all the capital stock of the El Tigre Mining Co., S. A. of Mexico, for the years 1909–1919, inclusive, is income under the acts of August 5, 1909, October 3, 1913, September 8, 1916, October 3, 1917, and February 24, 1919, and no deduction therefrom for depletion by reason of the exhaustion of the ore body of the El Tigre Mining Co. is allowed; and that any purported compromise entered into by the Commissioner of Internal Revenue with the Lucky Tiger-Combination Gold Mining Co., permitting such deduction was without authority in law and of no effect.

NOVEMBER 21, 1921.

For: Deputy commissioner, head Income Tax Unit.

MR. COMMISSIONER: The committee has considered the request of the Income Tax Unit for advice as to whether or not the Lucky Tiger-Combination Gold Mining Co. of Kansas City, Mo., is entitled as the holder of all the capital stock of the El Tigre Mining Co., S. A. of Mexico, to a deduction for depletion by reason of the exhaustion of the ore body of the latter company, and whether the purported compromise entered into by the Commissioner of Internal Revenue under date of March 15, 1912, with the Lucky Tiger-Combination Gold Mining Co., recognizing a right to depletion deduction and fixing the total amount of depletion, is binding upon the Government and upon the company.

The Lucky Tiger-Combination Gold Mining Co. was incorporated March 16, 1903, under the laws of the State of Arizona, for the purpose of operating a gold mining property located in the Republic of Mexico, within 60 miles of the international boundary line. By reason of the fact that under the laws of Mexico a foreign corporation is not permitted to acquire and operate a mining property within 20 leagues, or a little more than 60 miles, of the international boundary line (it is now 100 kilometers, or something more than 100 miles), the El Tigre Mining Co. was organized shortly thereafter under the laws of Mexico for the purpose of holding and operating the property. The stock of the El Tigre Mining Co. was and has continued to be held by the Lucky Tiger-Combination Gold Mining Co. An appraisal of the El Tigre Mining Co. property en bloc was made on January 1, 1909, and a valuation of $4,000,000 established. In a letter dated March 15, 1912, the then Commissioner of Internal Revenue appears to have accepted this valuation and to have consented to a depreciation or depletion deduction of $6 per ton based thereon, and on this basis the Lucky Tiger-Combination Gold Mining Co. filed amended returns for 1909 and 1910, and refunds aggregating $5,208.13 were allowed. The El Tigre Mining Co. has earned a large income during each of the years since 1909 and all of the avilable income has been paid over to the Lucky Tiger-Combination Gold Mining Co. as dividends and has constituted the chief source of income to the latter company.

In connection with these facts the Income Tax Unit submits the following specific questions:

"1. Whether the compromise arrangement effected by the commissioner's letter of March 15, 1912, is binding through the years of the operation of the taxpayer.

"2. Whether the foregoing compromise is binding upon the taxpayer during such period and also under the several laws subsequently enacted.

"3. Whether the amounts making up the depletion reserve of the operating company, assuming it might set up such a reserve, may be deemed to have been included in the dividends received by the taxpayer and to that extent made up of nontaxable returns of capital; or whether the total amount of dividends received by the holding company is deemed to be income taxable under the several laws."

For reasons which will hereafter appear the third question will be answered first.

Section 38, paragraph 2, of the act of August 5, 1909, provided that in ascertaining the net income of a corporation there should be deducted from the gross income received within the year from all sources, "a reasonable allowance for depreciation of property, if any."

In the case of Stratton's Independence *v.* Howbert (207 Fed. 419), affirmed by by the Supreme Court of the United States (231 U. S. 399), it was held that the "reasonable allowance for depreciation" provided in the act of August 5, 1909, did not contemplate an allowance for so-called wastage of property since depreciation did not ordinarily comprehend the removal of ore.

Section G (b) of the act of October 3, 1913, provided that the net income of a corporation should be ascertained by deducting from the gross income received within the year from all sources, "in the case of mines a reasonable allowance for depletion of ores * * *, not to exceed 5 per cent of the gross value at the mine of the output for the year for which the computation is made."

Section 12 (a) of the act of September 8, 1916, which was not amended by the act of October 3, 1917, provided that in the case of a corporation, organized in the United States, the net income shall be ascertained by deducting from the gross income received within the year from all sources, "in the case of mines a reasonable allowance for depletion thereof not to exceed the market value in the mine of the product thereof which has been mined and sold during the year for which the return and computation are made."

Section 234 (a) of the act of February 24, 1919, provides that in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as a deduction "in the case of mines, * * *, a reasonable allowance for depletion and depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted: * * *."

Article 201, Regulations 45 (1920 edition) provides in part that:

"Operating owners, lessors, and lessees, whether corporations or individuals, are entitled to deduct an allowance for depletion and depreciation, but a stockholder in a mining or oil or gas corporation is not allowed such deductions."

Although this regulation was made under the act of February 24, 1919, it is equally applicable as regards stockholders under each of the income tax acts above enumerated.

As has been repeatedly pointed out by the Supreme Court of the United States, a deduction for depletion is not a thing to which the owner of a mine is entitled as a matter of right in computing his net income, but is a concession made by the Congress in recognition of the equities existing in the case of such owner. (Stratton's Independence *v.* Howbert, 231 U. S. 399; Stanton *v.* Baltic Mining Co., 240 U. S. 103; Goldfield Consolidated Mines Co. *v.* Scott, 247 U. S. 126.) The Congress have seen fit to permit such deduction only in the case of mines, oil and gas wells, other natural resources and timber. The stockholders of a corporation do not own the property of the corporation. Their shares of stock represent only a right to a proportionate part of the assets upon dissolution of the corporation, and in the meantime to receive such dividends as may from time to time be declared. Stock in a mining corporation, therefore, is not a mine and the statute authorizes no deduction for depletion with respect thereto, by any of the acts cited, and the soundness of article 201, above quoted, is not an open question.

For a like reason the provision of article 1549, Regulation 45 (1920 edition) for the nontaxable distribution of depletion reserve can have no application to a foreign corporation receiving no income from sources within the United States.

It is suggested by the unit that the stock of the El Tigre Mining Co. had a value as of March 1, 1913, equal to the value of the mining property and therefore that the Lucky Tiger-Combination Gold Mining Co. should be allowed a return of such value tax free. It can not, however, be recognized that the holder of stock in a mining corporation occupies any different position from a stockholder of any other corporation. While the value of his stock may decrease with exhaustion of the ore body held by the corporation and may increase the reason of further development of such ore body or the discovery of additional ore bodies in the proprty, it is equally true that the value of the stock of any corporation fluctuates with the depreciation and appreciation of the assets of such corporation. Article 144, Regulations 45 (1920 edition) as amended by Treasury Decision No. 3206, which provides that—

"A person possessing securities, such as stock and bonds, can not deduct from gross income any amount claimed as a loss on account of shrinkage in value of such securities through fluctuation of the market or otherwise. The loss allowable in such cases is that actually suffered when the securities mature or are disposed of. * * * However, if stock of a corporation becomes worthless its cost, or if acquired prior to March 1, 1913, its cost or fair market value as of that date, whichever is lower, may be deducted by the owners in the taxable year in which the stock became worthless, provided a satisfactory showing of its worthlessness be made as in the case of bad debts"—

is, therefore, applicable to a stockholder in a mining corporation.

When the Lucky Tiger-Combination Gold Mining Co. disposes of the stock of the El Tigre Mining Co., or such stock matures or becomes worthless through the exhaustion of the property held by the El Tigre Mining Co., it will be entitled to deduct a loss represented by the difference between the cost or the March 1, 1913, value of the stock, whichever is lower, and the amount realized upon the sale or maturity of the stock, or, in case the stock becomes worthless, the full amount of said cost or value. Until that time no deduction by reason of the depletion of the property of the El Tigre Mining Co. is permitted.

The above conclusion necessitates a negative answer to the first and second quiries of the Income Tax Unit.

Under the provisions of the Revised Statutes and the administraitve provisions of the several acts above named, the Commissioner of Internal Revenue is authorized to make regulations for the collection of the taxes imposed by such acts. (Sec. 321 R. S.; 3447 R. S.; sec. 38, eighth, act of Aug. 5, 1909; sec. E, act of Oct. 3, 1913; sec. 22, act of Sept. 8, 1916; sec. 1005, act of Oct. 3, 1917; and sec. 1309, act of Feb. 24, 1919.) The power to make regulations, however, does not extend to the levying or remission of taxes, this power being reserved wholly to the Congress. Neither may the Commissioner compromise a tax legally due from a solvent taxpayer (art. 1011, Regulations 45 (1920 edition).) The compromise attempted to be effected by the commissioner and the taxpayer under date of March 15, 1912, was, therefore, without authority in law and must be held to have been ineffectual for any purpose.

The premises considered, it is held, in the case of the Lucky Tiger-Combination Gold Mining Co. of Kansas City, Mo, that the total amount of dividends received by this company as the holder of all the capital stock of the El Tigre Mining Co., S. A. of Mexico, for the years 1909–1919, inclusive, is income under the acts of August 5, 1909, October 3, 1913, September 8, 1916, October 3, 1917, and February 24, 1919, and no deduction therefrom for depletion by reason of the exhaustion of the ore body of the El Tigre Mining Co. is allowed; and that any purported compromise entered into by the Commissioner of Internal Revenue with the Lucky Tiger-Combination Gold Mining Co. permitting such deduction was without authority in law and of no effect.

N. T. JOHNSON,
Chairman, Committee on Appeals and Review.

Noted:

CARL A. MAPES,
Solicitor of Inernal Revenue.

Accepted for the guidance of the Income Tax Unit:

D. H. BLAIR,
Commissioner of Internal Revenue.

EXHIBIT B

JANUARY 19, 1925.

In re: Lucky Tiger Combination Gold Mining Co., Kansas City, Mo.

DEPUTY COMMISSIONER BRIGHT: Reference is made to your memorandum of November 20, 1924, in re Lucky Tiger Combination Gold Mining Co. of Kansas City, Mo., submitting for the consideration of this office the file in the above entitled case which was the subject of a memorandum, dated November 21, 1924 (No. 153), to the commissioner by the former committee on appeals and review (C. B. I-1, P. 179), answering the request of the Income Tax Unit for advice as to whether the taxpayer is entitled as the holder of all the capital stock of the El Tigre Mining Co., S. A. of Mexico, a foreign corporation, to a deduction for depletion by reason of the exhaustion of the ore body of the latter company. You state that while the former committee on appeals and review does not state specifically that the dividends received by the taxpayer from the El Tigre Mining Co., are subject to tax under the revenue act of 1918, it is considered that the committee intended to hold that the dividends are subject to tax in the hands of the recipient, which holding appears to be in conflict with the provisions of section 234 (a) (6) of the revenue act of 1918 and rulings of the department in respect to dividends received from a foreign corporation having income from sources within the United States.

The facts as stated in your memorandum are as follows:

"This corporation was organized in 1903 under the laws of Arizona and holds as its principal asset the entire capital stock of the El Tigre Mining Co., S. A. of Mexico. The El Tigre Mining Co. was necessary as an operating company for the reason that the mining property lies within a certain zone of Mexico near the boundary of the United States in which foreign corporations are, under the laws of Mexico, not permitted to own or operate property. The greater portion of the income of the taxpayer is received from the Mexican corporation in the form of dividends which amounted to $900,000 for each of the years 1918, 1919, and 1920. The El Tigre Mining Co. for the years 1918, 1919, and 1920 received certain minor income from sources within the United States, it being in the nature of receipts from sale of surplus power to consumers in Douglas, Ariz. On these facts you inquire whether the unit should consider the dividends in question as nontaxable income in the hands of the recipient."

Section 230 of the revenue act of 1918 provides:

"(a) That in lieu of the taxes imposed by section 10 of the revenue act of 1916, as amended by the revenue act of 1917 and by section 4 of the revenue act of 1917, there shall be levied, collected, and paid for each taxable year upon the net income of every corporation a tax at the following rates: * * *."

Section 232 of the act provides:

"That in the case of a corporation subject to the tax imposed by section 230 the term 'net income' means the gross income as defined in section 233 less the deductions allowed by section 234. * * *."

Section 233 provides:

"(a) That in the case of a corporation subject to the tax imposed by section 230 the term 'gross income' means the gross income as defined in section 213, except that:

* * * * * * *

"(b) In the case of a foreign corporation gross income includes only the gross income from sources within the Unites States, including * * * dividends from resident corporations, and including all amounts received (although paid under a contract for the sale of goods or otherwise) representing profits on the manufacture and disposition of goods within the United States."

Section 234 (a) provides:

"That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

"(6) Amounts received as dividends from a corporation which is taxable under this title upon its net income, * * *."

The principle involved in the instant case has been previously considered by this office. In L. O. 1054 (C. B. 3, p. 193) it is stated that it is evident from reading the several above-quoted sections of the act that—

"Every foreign corporation which receives income from sources within the United States is taxable upon its net income as defined in the statute. The fact that a particular foreign corporation which receives income from sources within the United States has, by reason of the deductions provided in the statute, no net income as defined by the statute does not relieve it from liability to tax. It is still taxable upon its net income."

Furthermore, it is held in this law opinion that under the express provisions of section 216 of the revenue act of 1918, the American stockholders of a foreign corporation are entitled to a credit for the amount received as dividends from the corporation.

Section 320 of the revenue act of 1918 provides that:

"* * * for the purpose of this title (Title III, war-profits and excess-profits tax) the net income of a corporation shall be ascertained and returned * * * (3) For the taxable year upon the same basis and in the same manner as provided for income-tax purposes in Title II of this act."

Accordingly under the principle of L. O. 1054, amounts received as dividends by a domestic corporation from a foreign corporation which is taxable under the revenue act of 1918 is an allowable deduction in computing the net income of the corporation and therefore exempt from tax in the hands of the recipient under the revenue act of 1918. The test of the taxability of such dividends is whether or not the foreign corporation received income from sources within the United States. The amount of the dividends and the amount of income from sources within this country appears to be immaterial. In Advisory Tax Board Memorandum No. 21 (C. B. 1, p. 160), it is stated that "any amount however large received as dividends from a corporation taxable upon income from sources within the United States, however small such income may be, is exempt from the normal tax under section 216 (a), or, in case the recipient is a corporation, under section 234 (a) (6)."

It appears that the committee on appeals and review in its opinion only considered the question of whether the taxpayer was entitled to a deduction for depletion by reason of the exhaustion of the ore body of the El Tigre Mining Co. However, the ruling may be fairly interpreted as holding that the dividends in question were taxable in the hands of the recipient. It must be assumed, therefore, that the ruling is based in the premise that the foreign corporation received no income from sources within the United States. In this connection it may be remarked that the representatives of the taxpayer in their brief state that the El Tigre Mining Co. derived income from sources within the United States during the years 1917, 1918, 1919, and 1920, and that such income has been returned and the tax thereon paid. This office has been unable to confirm this statement from the file. The file contains certain contracts under which the El Tigre Mining Co. might have derived income from sources within this country but the revenue agent in his report of October 25, 1923, indicates that he has been unable to establish the fact that income was actually received by the company under these contracts.

Therefore, in the absence of evidence showing that the El Tigre Mining Co. actually derived income from sources within the United States during the years 1918, 1919, and 1920, it must be concluded in view of the foregoing, that the dividends in question are subject to tax. If it can be clearly established that the El Tigre Mining Co. actually received income from sources within this country under the principle of L. O. 1054 and T. B. M. 21, supra, the dividends of the corporation in the hands of the recipient under the revenue act of 1918 are nontaxable.

Your attention is invited to the fact that a "tentative report" for the calendar year 1919 was executed by the Lucky Tiger Combination Gold Mining Co. on March 15, 1920, and the income and profits-tax return for the same year was executed on May 15, 1920. Conseqnently any adjustment with respect to this return should be made within the statutory period of limitation.

NELSON T. HARTSON,
Solicitor of Internal Revenue.

NOVEMBER 12, 1925.

Memorandum to Mr. C. R. Nash, assistant to the commissioner.
In re: Lucky Tiger-Combination Gold Mining Co., Kansas City, Mo.

Reference is made to the criticism by the Senate committee relative to the manner in which the Bureau of Internal Revenue closed the case of the Lucky Tiger-Combination Gold Mining Co., Kansas City, Mo., for the taxable years 1917 and 1918.

It appears that the Lucky Tiger-Combination Gold Mining Co. was organized under the State laws of Arizona and owned one hundred per cent of the capital stock of the El Tigre Mining Co. (a foreign corporation) organized under the laws of the Republic of Mexico. During the taxable years 1917, 1918, 1919, and 1920, the former company received dividends from the latter company in the amounts of $396,246.50, $900,000, $900,000, and $900,000, respectively. During the audit of the case by the Income Tax Unit the question arose as to whether or not the dividends mentioned above, were taxable to the Lucky Tiger-Combination Gold Mining Co., a company organized in the United States.

Under the revenue acts of 1917 and 1918, dividends received by a domestic corporation from a foreign corporation that is taxable under the revenue laws of the United States, are exempt from tax. The question then arose, whether the El Tigre Mining Co. received any income during the years in question, from sources within the United States, and if so, did the amount of such income received, govern the allowance of the dividends as nontaxable income to the domestic corporation.

The question was submitted to the Solicitor of Internal Revenue who rendered an opinion thereon dated January 19, 1925, in which it was held that if it were shown that the El Tigre Mining Co. did, as a matter of fact, receive income from sources within the United Staes (and pay a tax thereon) then no matter how small the amount of income, the dividends were not taxable to the Lucky Tiger-Combination Gold Mining Co.

The taxpayer has proven its contention with documents that can not be controverted and I am constrained, therefore, to view the closing of the case as proper under the law and regulations.

C. B. Allen,
Assistant Deputy Commissioner.

H. A. Metz & Co.

[By Geo. G. Box, July 23, 1925]

AFFILIATION, NO DEFINITE METHOD OF DETERMINING

Complaint was made to the committee by Mr. D. F. Hickey, formerly employed as auditor, consolidated returns audit division, section B of the Income Tax Unit, in regard to the settlement of this case.

The complainant states that the taxpayer protested against the unit's ruling that itself and a large number of other companies were not affiliated during the years from 1917 to 1920; that a representative of the taxpayer, an official of the company, had an informal discussion regarding the question with H. L. Robinson, chief of audit section B; that the said Robinson instructed Lawrence J. Potter, an auditor of the affiliation unit of that section, to confer with the representative of the taxpayer and consider his arguments on the question of affiliation; that the said Potter informed the representative that the statute controlling for the years from 1918 to 1920 had not been interpreted by the solicitor's office in such a manner as would justify him in allowing a claim of affiliation in any case where the stockholdings fell as far short of the required percentages as they did in this case, and that with respect to the year 1917, section 1331 of the revenue act of 1921 absolutely closed the door to such cases as this for the reason that no provision was made therein for affiliation in class B cases on the ground that stock was controlled; that in class B cases affiliation could be recognized for 1917 only where the stock was actually owned in the required percentages; that the said Potter reported his findings to his chief, Robinson, but nevertheless the latter subsequently instructed the said Potter to rule the group of companies affiliated for all years, which action was a reversal of the original and proper ruling; that Potter followed the orders of his chief, Robinson; that upon an audit of the case based on the affiliation ruling above mentioned a refund of about $500,000 was found due, and that on account of the fact that the refund was in excess of $50,000 under the procedure in the Income Tax Unit the case was required to be reviewed by the Solicitor before the overassessment certificate was issued.

The complainant states further that under date of April 19, 1924, the solicitor handed down an opinion rejecting the claim on the ground that consolidation should have been denied, and returned the case to the unit for audit on the basis of separate returns, in accordance with the original and proper nonaffiliated ruling; that under date of July 9, 1924, the solicitor handed down another opinion on this case ruling the group of corporations affiliated including even 1917, despite the fact that the law for that year, as pointed out by the solicitor's office, is especially unfavorable to consolidation in such cases as this and that the latter opinion was palpably wrong for the years from 1918 to 1920 and "a hideous farce as to 1917."

Complainant further states that the chief of the new affiliation section telephoned to the solicitor's office and requested to be advised why the solicitor had reversed himself in this matter and was informed that the reversal had been ordered by the Commissioner of Internal Revenue; that John Chandler Hume, the taxpayer's attorney subsequently met Auditor Potter and informed him that upon the taxpayer being advised of the solicitor's decision of April 19, 1924, Senator Wadsworth of New York had been appealed to and the latter telephoned to Commissioner Blair and arranged to have the opinion of the solicitor reversed in accordance with the taxpayer's wishes.

The corporations which were decided to be affiliated with the taxpayer for the years from 1917 to 1920, inclusive, are as follows:

H. A. Metz Laboratories (Inc.), engaged in the business of manufacturing salvarsan drugs and other pharmaceutical preparations.

Consolidated Color & Chemical Co., engaged in the business of manufacturing chemicals, dyestuffs, and kindred products.

Farbwerke-Hoechst Co., engaged in the business of wholesale distributor of drugs and chemicals.

Salvarsan Co., was a nonoperating company during the years in question.

Fat Ferment Co., nature of business not indicated. Capitalized at $10,000. Stock to the par value of $9,000 was issued in exchange for formulas.

Textileather Co., engaged in the business of manufacturing leather substitutes.

Plexo Preparations (Inc.), engaged in the business of manufacturing toilet articles.

General Drug Co., engaged as wholesale jobbers of drugs, including the entire product of the last above-named corporation.

Stoneville Co., owns all of the houses occupied by the employees of the Ettrick Mills.

Ettrick Mills, engaged in the manufacture of cloth.

Ettrick Realty Co., engaged in the real estate business.

The record of the case shows the following:

Prior to April 1, 1921, affiliated corporation questionnaires were mailed to the taxpayer and H. A. Metz Laboratories (Inc.).

Under date of April 18, 1921, Henry G. Fritsche, attorney for the latter company and the taxpayer wrote the Commissioner of Internal Revenue informing him that the corporations in question had not received the questionnaires, but that—

"Said corporation (taxpayer) is not affiliated within the meaning of your regulations and Treasury Decision 2662 and section 240 of the revenue act of 1918. This company does not own any capital stock in any corporation, nor is any of its capital stock owned by any other corporation * * *. The H. A. Metz Laboratories (Inc.), does not own a majority of capital stock in any corporation * * *. None of the capital stock of the H. A. Metz Laboratories (Inc.), is owned by any other corporation.

"It is not even true that all of the issued stock of the two corporations in question is owned or controlled by the same interests.

"You will please note that the holdings in the H. A. Metz & Co. (Inc.), and the H. A. Metz Laboratories (Inc.), are not by the identical stockholders, nor is the stock of said corporations held in substantially the same proportion by the stockholders."

He states further that—

"H. A. Metz & Co. (Inc.), is a dealer in dyestuffs, chemicals and kindred products, and sells many products not manufactured by the H. A. Metz Laboratories (Inc.).

"H. A. Metz Laboratories (Inc.), are manufacturing chemists. They do not, however, sell their entire output to the corporation, H. A. Metz & Co. (Inc.). Each corporation is separate and distinct, and run on a different basis."

On March 25, 1922, the Income Tax Unit ruled that the taxpayer, the H. A. Metz Laboratories (Inc.), the Farbwerke-Hoechst Co., and the Fat Ferment Co. were affiliated during the taxable year 1917 within the purview of Articles 77 and 78 of Regulations 41 and T. D. No. 2662, and should therefore have filed a consolidated excess-profits tax return for 1917. Also that H. A. Metz Laboratories (Inc.), Farbwerke-Hoechst Co., and Fat Ferment Co. were affiliated during the taxable years from 1918 to 1920 inclusive, within the purview of section 240 of the revenue act of 1918, and therefore consolidated returns should have been filed for those years. All corporations not mentioned above should be taxed separately.

On June 23, 1922, the Income Tax Unit ruled that all of the 12 companies mentioned above were affiliated for the years from 1917 to 1920, inclusive, under section 240 of the revenue act of 1918 and section 1331 of the revenue act of 1921.

On June 16, 1923, another decision was reached by the unit, in which it was held that H. A. Metz Laboratories (Inc.), Fat Ferment Co., General Drug Co. (Inc.), and H. A. Metz & Co. (Inc.), were affiliated for the year 1917 and the H. A. Metz Laboratories (Inc.), Fat Ferment Co., General Drug Co., Stoneville Co., and Ettrick Mills, were affiliated for the years from 1918 to 1920, inclusive, and the balance ruled not affiliated.

On June 19, 1923, as a result of a protest from the taxpayer, the last above-mentioned ruling of the Income Tax Unit was revoked and the ruling mentioned immediately preceding it above revised.

A report of a field examination for the year 1917 dated February 6, 1923, was made considering all 12 of the corporations affiliated in accordance with instructions received from the bureau. On February 16, 1924, report of a field examination for the years from 1918 to 1920, inclusive, was made, based on the assumption that all companies were affiliated, under instructions from the bureau.

As a result of the audit of these reports, certificates of overassessment were found on account of the year 1917 which were required under the procedure of the Income Tax Unit to be forwarded to the solicitor for his consideration before final action by the unit, for the reason that the aggregate amount involved exceeded $50,000.

Under date of April 19, 1924, the Solicitor of Internal Revenue returned the certificates of overassessment without approval for the following reasons:

"It appears that Herman A. Metz, who is the majority stockholder of most of the corporations, owned during 1917 only 50 per cent of the stock of the Consolidated Color & Chemical Co., 50 per cent of the stock of the Textileather Co., none of the stock of the Salvarsan Co. or of the Plexo Preparations Co., and only 20 per cent of the stock of the Ettrick Realty Co.

"As it appears from the file that the affiliation for 1917, if any, was of the class B variety and on account of the ownership of stock by Herman A. Metz, there may be at once eliminated from the consolidation the Salvarsan Co. and the Plexo Preparations Co., in neither of which did he own any stock.

"As to the Consolidated Color & Chemical Co. and the Textileather Co., passing over the question whether these corporations were engaged in the same or a closely related business, it appears that the minority stockholders in the two companies were not the same people. It further appears that in these two companies Herman Metz's holdings amounted to only 50 per cent. In view of the circumstances, the Consolidated Color & Chemical Co. and the Textileather Co. must also be eliminated from the affiliation.

"The Stoneville Co., the Ettrick Mills, and the Ettrick Realty Co. must also be eliminated from the main group for the reason that although Metz owned 97.3 per cent of the stock of the Stoneville Co. and 99.9 per cent of the stock of the Ettrick Mills, these corporations do not appear to be engaged in the same or a closely related business with the members of the main group, which is the manufacture and sale of dyes, drugs, and chemicals. There does not appear to be in the file any evidence that these two corporations bought from or sold to any of the members of the main group, or any other corporations, products, or services at prices above or below the current market or that the financial relationships of these two corporations were so arranged with any other corporations as to assign to them a disproportionate share of the net income or invested capital. The Ettrick Mills is engaged in the manufacture of cloth, while the Stoneville Co. holds title to the real estate occupied by the employees of the Ettrick Mills. The Ettrick Realty Co. appears to be in the business of handling real estate, and so far as the file shows its business is not connected with that of the other corporations under discussion. Moreover in this last-named corporation Herman A. Metz owned only 20 per cent of the stock, the remaining 80 per cent being owned by his wife. It is unnecessary to decide whether the Stoneville Co. and the Ettrick Mills should form a consolidated group by themselves in view of the fact that neither singly nor combined did these corporations have income sufficient in amount to be subject to excess profits tax. For the foregoing reasons the Stoneville Co., the Ettrick Mills, and the Ettrick Realty Co. should be eliminated from the consolidation.

"This leaves for consideration the following companies: H. A. Metz & Co., H. A. Metz Laboratories (Inc.), Farbwerke-Hoechst Co., Fat Ferment Co., and the General Drug Co.

"As to the Farbwerke-Hoechst Co., while Herman A. Metz claims to have owned all of the stock during 1917, the action of the Alien Property Custodian in seizing in 1918, 1,990 of the 2,000 shares of its stock as enemy property would seem to cast doubt upon Metz's ownership during 1917 of any but 10 of the shares.

The Alien Property Custodian appears to have doubted the bona fides of the retransfer to Metz in July, 1913, by the former German owner of 1,990 shares previously sold by Metz to the German. Under the circumstances the question of Metz's ownership of the shares in 1917 will be solved by the answer to the question whether he was the bona fide owner in 1918 at the time of the Alien Property Custodian's seizure of the stock. This question should be determined in accordance with the decree of the court in the suit which Metz filed against the Alien Property Custodian for the return of the stock seized. It does not appear from the file what the outcome of that suit was.

"It appears that while Herman A. Metz owned 99.2 per cent of the stock of H. A. Metz & Co. at the beginning of 1917, his holdings at the close of 1917 amounted only to 49.4 per cent. It does not appear when Herman A. Metz ceased to own practically all of the stock of this company. H. A. Metz & Co. should be affiliated with the remaining members of the group for that period only in 1917 during which Metz owned practically all of the stock.

"In view of the fact that Metz owned 97.89 per cent of the stock of the Fat Ferment Co., 97 per cent of the stock of the General Drug Co., and 99.4 per cent of the stock of the H. A. Metz Laboratories (Inc.), and in view of the fact that these corporations appear to have been engaged in the same or a closely related business, they may properly be affiliated for excess profits tax purposes in 1917. It is true that Herman A. Metz appears to have owned only 4 out of the original 1,000 shares of H. A. Metz Laboratories (Inc.), upon the issue of stock April 28, 1917, but it appears that 990 additional shares were issued to him by this corporation shortly thereafter, so that for practically all of the corporations' effective existence in 1917 Herman A. Metz owned 99.4 per cent of its stock.

Under date of July 9, 1924, the solicitor, referring to his memorandum of April 19, 1924, wrote Deputy Commissioner Bright as follows:

"Reference is made to the file of the above-named taxpayer containing a certificate of overassessment for the year 1917 in the amount of $57,221.69 in favor of the Consolidated Color & Chemical Co., one of the affiliated group. Reference is also made to my memorandum of April 19, 1924, in the same case.

"In that memorandum there were excluded from the affiliated group the following corporations: Salvarsan Co., Plexo Preparations Co., Consolidated Color & Chemical Co., Textileather Co., Stoneville Co., Ettrick Mills, and the Ettrick Realty Co. The inclusion in the affiliated group of the Farbwerke-Hoechst Co. was made dependent upon the outcome of a suit in equity filed by Metz for the recovery of stock seized by the Alien Property Custodian, the outcome of which was unknown at the time my memorandum was written. It has been since ascertained that Metz was successful and that he owned the stock in 1917.

"Since the date of my memorandum the question of affiliation has been resubmitted, and additional evidence has been introduced tending to show that while, according to the stock books of the corporations involved, Herman A. Metz was not the owner of substantially all the stock of the corporations, nevertheless the stock which was nominally owned by others was in reality his, and that the certificates which had been issued to these other persons had been assigned in blank and were in the possession and complete control of Herman A. Metz.

"In view of the foregoing facts I am of the opinion that the evidence warrants the affiliation of the corporations for excess profits-tax purposes for the year 1917, and the certificate of overassessment in favor of the Consolidated Color & Chemical Co. is therefore approved."

As a result of the decision of the solicitor of July 9, 1924, the case was reaudited and on September 29, 1924, certificates of overassessment were issued in the following amounts:

1917, overassessment	$78, 355. 97
1918, overassessment	302,606. 78
1919, overassessment	122, 479. 56
1920, overassessment	135, 959. 74
Total	639, 402. 05

Only minor adjustments were made by the bureau in auditing the net income and invested capital as submitted in the returns of the several corporations, so that practically the whole of the aggregate overassessments was found as the result of considering the 12 corporations on a consolidated basis for the years in question.

On August 28, 1924, Mr. J. R. Riggles addressed a memorandum to Mr. Charest, Assistant Solicitor of Internal Revenue, in regard to the certificates of overassessment for the year 1918, as follows:

"This is a consolidation of 12 companies and the above refunds arise from consolidation, whereas separate returns were originally filed. As you know, the affiliation was ruled upon by this office and resulted in a conference in the commissioner's office and it was finally decided to allow the affiliation if the taxpayer would submit in affidavit form the facts relating to the ownership of stock by Metz.

"The records of the corporation showed that the stock of these 12 companies was widely distributed among the officers and employees of the companies and it was contended that Metz in fact had the stock indorsed in black and used it for all purposes. These affidavits, I understand, were accepted by this office but the unit is unable to locate them at this time.

"I am not entirely satisfied with the affiliation on the showing in the record, but am accepting the case on the basis of the action taken by this office on the year 1917. The other questions in issue such as contributions to capital by Metz were passed upon when the 1917 portion of the case was considered. I therefore recommend that the case be approved in view of the previous action taken by this office."

Under date of September 25, 1924, Mr. Riggles, in considering the certificates of overassessment for the years 1919 and 1920, addressed Mr. Charest as follows:

"The main question in this case is affiliation. When the 1917 portion of the case was submitted to this office for approval it was held that a class B affiliation had not been established by the taxpayer. A conference was held in the commissioner's office and it was finally decided to allow the affiliation if the taxpayer would submit in affidavit form the facts relating to the ownership of stock by Metz. Although the evidence in the case does not appear entirely satisfactory, nevertheless I am passing the question of affiliation inasmuch as this office has already allowed it for the years 1917 and 1918. The consolidation of the 12 affiliated companies operates to the benefit of the taxpayer inasmuch as eight of the companies show operating losses aggregating $89,000 for 1919 and $39,000 for 1920. Returns were filed by each company and those showing income were assessed separately. Upon a consolidated basis the tax has now been allocated to those showing income, leaving an overassessment in favor of the parent company. There are no changes in the income accounts with the exception of an inventory item of $47,958.34 which had been disallowed for the year 1918 and consequently will reduce the 1919 income by that amount.

"I am attaching herewith my memorandum on the 1918 portion of the case which sets forth the history of the affiliation of these companies.

"It is, therefore, recommended that the certificates be approved."

It appears from these memoranda that after the first ruling handed down by the solicitor a conference was held in the commissioner's office at which it was decided to allow affiliation if the taxpayer submitted certain facts in affidavit form relating to the ownership of the stock by H. A. Metz. Also that the consolidation of the 12 corporations benefitted the taxpayer for the reason that eight of the corporations showed operating losses during the years 1919 and 1920. These losses of course, in considering the 12 corporations consolidated, would have the effect of reducing the aggregate net income and increasing the invested capital of the consolidated group.

In summarizing this case the following facts are emphasized:

In 1921 Attorney Fritsche, representing H. A. Metz & Co. (Inc.), and H. A. Metz Laboratories (Inc.), went on record as stating that these corporations were not affiliated within the meaning of the Treasury regulations and the interpretation of the revenue act of 1918; that the issued stock of the two corporations was not owned or controlled by the same interests and that the holdings in these two corporations were not by the identical stockholders, nor was the stock thereof held in substantially the same proportion by the different stockholders.

On March 25, 1922, the unit ruled that four of the corporations were affiliated for the year 1917; three were affiliated for the years from 1918 to 1920, and that the balance were not affiliated.

On June 23, 1922, the unit ruled that all of the 12 corporations were affiliated for the years from 1917 to 1920, inclusive.

On June 16, 1923, one year later, the unit ruled that four of the corporations were affiliated for 1917 and five were affiliated for the years from 1918 to 1920.

On June 19, 1923, as the result of a protest to the last above-mentioned decision, it was set aside.

On April 19, 1924, the Solicitor of Internal Revenue decided that the Fat Ferment Co., the General Drug Co., and the H. A. Metz Laboratories (Inc.) were deemed to be affiliated for excess-profits tax purposes for the year 1917 for the reason that H. A. Metz owned over 97 per cent of the stock of the three companies, "in view of the fact that these corporations appear to have been engaged in the same or a closely related business"; H. A. Metz & Co. should be affiliated with the remaining members of the group for that period only in 1917 during which Metz owned practically all of the stock; and that the other corporations were not affiliated for reasons stated in his memorandum. In regard to the Stoneville Co., the Ettrick Mills, and the Ettrick Realty Co., he decided that these corporations must be eliminated from the main group for the reason that, regardless of the stock ownership therein by H. A. Metz, "these corporations do not appear to be engaged in the same or a closely related business with the members of the main group, which is the manufacture and sale of dyes, drugs, and chemicals. There does not appear to be in the file any evidence that these two corporations bought from or sold to any of the members of the main group or any other corporations products or services at prices above or below the current market, or that the financial relationships of these two corporations were so arranged with any other corporations as to assign to them a disproportionate share of net income or invested capital."

In the solicitor's memorandum of July 9, 1924, which refers to his memorandum of April 19, 1924, he decides that in view of the fact that subsequent to April 19, 1924, additional evidence has been introduced tending to show that although according to the stock books of the corporations involved, Herman A. Metz was not the owner of substantially all the stock of the corporations, nevertheless the stock which was nominally owned by others was in reality his and that the certificates which had been issued to these other persons had been assigned in blank and were in the possession and complete control of Herman A. Metz, he was of the opinion that the evidence warrants the affiliation of the corporations for excess-profits tax purposes for the year 1917.

In the latter decision the corporations in question are ruled affiliated wholly on the evidence submitted tending to prove that the certificates of stock of the different companies were in the possession and control of Herman A. Metz. It appears that the solicitor failed to consider, in making this decision, whether or not the corporations were engaged in the same or a closely related business or whether one corporation bought from or sold to another corporation products or services at prices above or below the current market, which he mentioned in his decision of April 21, 1924, and which is a provision in section 1331 of the revenue act of 1921 providing for the consolidation of corporations for the year 1917. In other words, under the section last above mentioned for a class B affiliation for the year 1917, not only must substantially all the stock of the corporations be owned by the same interests but the corporations must be engaged in the same or a closely related business, or one corporation purchase from or sell to another corporation products or services below the current market prices.

In the solicitor's opinion of April 21, 1924, he stated that some of the corporations were not in the same or a closely related business and that this provision of the 1921 law was not complied with, yet under the July 9, 1924, decision he overlooks this provision of the law and allows affiliation on evidence produced to show the possession of the stock certificates and complete control of the corporation by Metz.

It is obvious from the record that there was a desire in the bureau to give this taxpayer the benefit of submitting a consolidated return covering the 12 corporations and that notwithstanding the solicitor's opinion of April 19, 1924, the case was resubmitted to him and another decision obtained by which the taxpayer was given what it sought as a result of which over $600,000 in taxes was lost to the Government.

GEO. G. BOX, *Chief Auditor.*

TREASURY DEPARTMENT,
Washington, October 30, 1925.

Hon. JAMES COUZENS,
Chairman Senate Investigating Committee.

DEAR MR. CHAIRMAN: Reference is made to the report of the representative of the investigating committee with reference to the case of H. A. Metz & Co. (Inc.), New York, N. Y. In this report the committee's agent criticizes the ruling of the bureau with respect to the affiliation of H. A. Metz & Co. (Inc.), with certain other corporations.

The question of whether or not two corporations are affiliated in a given case is one of the most difficult questions which the department has had to determine. In the last analysis the question is one of judgment and in this case this question of judgment was decided after the matter had received careful consideration by the bureau. The report of the committee's agent in this matter evidences only that his judgment differs from that of the bureau in its disposition of this question. Such differences of judgment are inevitable and in my opinion demonstrate nothing.

I should like to point out that the question involved in this case is no longer of any practical importance since the revenue act of 1924 lays down clear and strict, although arbitrary, rules for determination of this and similar cases.

Sincerely yours,

D. H. BLAIR, *Commissioner.*

J. G. McCASKEY AND LOUIS WENTZ, TRUSTEES

[By F. B. Potter, August 15, 1925]

TRUSTEES SHOULD HAVE BEEN TAXED AS CORPORATION

Overassessment of $322,740.97 for the year 1917 was allowed, that amount representing the entire assessment for the year.

This organization filed its return as a corporation or association and was assessed as such and obtained the above certificate of overassesement on the ground that it should be taxed as a trust and that the cestui que trustent should be taxed and not the fiduciary

The action of the Income Tax Unit, together with authorities and reasons, is set forth in a statement attached to the certificate of overassessment. Such statement reads as follows:

Prior to April 14, 1917, the Southwestern Oil Co., Ponca City, Okla., an Oklahoma corporation, operated certain oil leases in the State of Oklahoma. On that date at a meeting of the stockholders it was mutually agreed that the corporation should dissolve and that the entire property and assets of the corporation should be turned over to trustees for the purpose of disposing of its assets and winding up its affairs. Accordingly, the property was turned over to trustees. By the terms of the instrument creating the trust Mr. J. G. McCaskey and Mr. Louis Wentz were named trustees. They were to receive and hold the legal and equitable title to all of the property and leases theretofore belonging to the corporation for certain uses and purposes specifically set forth in the declaration of trust and with certain duties, powers, and obligations also set forth therein.

On May 17, 1921, the committee on appeals and review transmitted to this office for its guidance with respect to the taxable status created by the above-mentioned trust instrument solicitor's memorandium 130, the substance of which is contained in the part thereof reading as follows:

"This office is, therefore, of the opinion that McCaskey and Wentz, trustees, should be treated as a trust for the purpose of Federal income tax. Since the trust instrument provides that the trustees are to pass the income over to the shareholders from time to time as they deem reasonable in a businesslike management of the trust property, such income is distributable periodically, whether or not at regular intervals within the meaning of section 219 (4) of the revenue act of 1918, and should be taxed individually to the shareholders. (Sec. 219 (d).)

"This ruling is based on the facts as they now stand. If through subsequent transfer of the share-ownership a majority of the beneficial shares should come into the possession of the trustees, a further ruling as to the taxable status of the organization will be necessary."

McCaskey and Wentz, trustees, were officially notified of this decision and its effect in office letter dated June 13, 1921. Permission was granted to the trustees to file amended tax returns in accordance therewith for each of the taxable years 1917 to 1919, inclusive. It was also suggested that the various beneficiaries of the trust file amended returns in order to account in their respective individual tax returns for the proportionate part of the proceeds of the trust accruing to them for the taxable year 1917.

An audit of the amended 1917 fiduciary tax return, filed by the above-mentioned trustees, was completed in February, 1923, and at the same time adjustments were made in the respective tax liabilities of the various beneficiaries of the trusteeship for the taxable year 1917.

It is noted that prior to the above-mentioned solicitor's memorandum, McCaskey and Wentz, trustees, had filed an income and excess profits tax return for the taxable year 1917 as an association, taxable as a corporation. The original returns filed showed a tax liability under such taxable status of $287,357.80. This original tax liability was later increased as a result of an office audit in September, 1920, to $322,740.97, an increase of $35,383.17. According to the records of this office it appears that an amount of $172,053.37 was paid of the original tax liability of $287,357.80 by the trustees, and a claim for abatement of the balance of $115,304.43 was later filed by them on July 5, 1921, with the collector of the Oklahoma district. The above-mentioned additional tax of $35,383.17 was also made the subject of an abatement claim filed November 9, 1920, by the above-mentioned trustees, with the collector of the Oklahoma district.

It will be observed that as a result of solicitor's memorandum 130 the trusteeship was not liable for tax as an association, and therefore all taxes assessed against and paid by the trustees on the basis of such taxable status were in error and consequently subject to abatement or refund.

The taxable status created by the trust instrument was that of a distributable trust, the proceeds or net income of the trust property from operations being therefore subject to tax in the hands of the beneficiaries of the trust.

As hereinbefore stated adjustment of the tax liability for the taxable year 1917 of each of the beneficiaries of the trust has been made in February, 1923, and therefore, the tax originally assessed against and paid by the trustees on the erroneous taxable status as an association, is properly subject to abatement or refund.

An examination of the amended fiduciary return discloses that there is no liability for tax for the taxable year 1917 on the part of McCaskey and Wentz, trustees, as trustees and, therefore, there being no liability for tax, the adjustments contemplated and outlines in the foregoing statements and attached certificate of overassessment are proper and in order.

Upon examination of the organization papers, called a trust deed, under which this company acted, I find and wish to show that the Internal Revenue Bureau was wrong in its premises, its conclusions and in all action taken, and for convenience the case will be discussed according to the following outline:

1. The bureau misstated and misinterpreted the facts.
2. The organization should have been taxed as a corporation.
3. The tax should have been paid by the trustees whether the organization was taxed as a trust or not.
4. The law is hazy and indefinite thus permitting abuse of administrative discretion.

1. Reference is made to the facts used as a basis for the action of the bureau shown in the first and third paragraphs of the statement quoted above. The true facts set out for contrast are as follows:

The beneficial ownership in the organization was divided into 1578½ shares. J. S. Cosden held 465.12, M. F. McCaskey 450 shares, L. H. Wentz 321.3 shares, and the remaining shares were held by six other persons in amounts varying from 1 to 77 shares.

The Southwestern Oil Co. transferred its assets including leases, equipment, and choses in action to trustees on April 14, 1917, not for the purpose of "winding up its affairs" as that was effected as soon as shares in the trusteeship were issued and accepted in lieu of the shares of stock, but for the purpose of operation for profit.

The trustees were authorized and directed to manage and operate the oil properties, to sell oil leases or buy oil leases, to employ labor, to borrow money, to market oil, and to do all things incidental to operation.

The trustees were authorized, with the consent of a majority of the stockholders, to change the form of organization back to a corporation. The period of the trust was named as 15 years with provision for extension. The trustees were empowered to distribute earnings to the shareholders or to invest in other properties as they should deem "wise" or "beneficial" or "reasonable."

The provision was made in the trust deed that all contracts should limit the liability of shareholders and of trustees. The statement used by the bureau thus appears misleading.

2. This company should have been taxed as a corporation under the revenue act of 1917, section 10 (a), the income tax, and should have been taxed as a corporation for all purposes for subsequent years. Permission was given the taxpayer to file amended returns as a fiduciary for the years 1917 to 1919, inclusive, and a refund of the 1917 tax was made in 1923 when there were several years' tax due, if the organization was taxable as a corporation.

The revenue act of 1918, section 1, states:

"The term 'corporation' includes associations, joint-stock companies, and insurance companies.

"The term 'domestic' when applied to a corporation or partnership means created or organized in the United States."

This company was operating for profit, had transferable shares, and otherwise fell within the description of an association or "Massachusetts trust," or a common-law corporation, and was hence taxable. This particular case is clearly within the interprotation of the statute found in Hecht et al. v. Malley (44 Sup. Ct. 462, case 171, Prentice-Hall Supplement, 1925), decided May 12, 1924, and as to cases less clearly taxable the law will be discussed hereinafter.

The bureau held "The taxable status created by the trust instrument was that of a distributable trust, the proceeds or net income of the trust property from operations being therefore subject to tax in the hands of the beneficiaries of the trust."

With the "trust instrument" before the bureau and with such instrument clearly transferring title in all the leases, oils, wells, equipment and personal property, and clearly directing the trustees to manage and operate such property, the holding that this was a "distributable trust" is not merely erroneous; it is unthinkable.

3. The tax should have been paid by the trustees even if the business was taxed as a trust.

Section 219 of the revenue act of 1918, and also of the act of 1921, provides that the trust income is taxable to the trustees except—

"(a) 4. Income which is to be distributed to the beneficiaries periodically, * * *."

In this case the trustees had the discretion to pay or not to pay and the beneficiaries had no enforceable right to receive the income, hence it could not be taxed in their hands until received because it is not income. The language above quoted "which is to be distributed" refers to trusts in which distribution can be enforced under the trust instrument, but should not be read "which is to be or not to be distributed as the trustees may wish."

4. The revenue laws so far as pertinent to the subject of business or operating trusts will be reviewed for the purpose of constructive criticism.

The revenue act of August 5, 1909, section 38, provided:

"That every corporation, joint-stock company, or association, organized for profit and having a capital stock represented by shares, and every insurance company, now or hereafter organized under the laws of the United States or any State or Territory * * * shall be subject to pay annually a special excise tax * * *."

In Eliot v. Freeman (220 U. S. 178), decided in 1911, it was held that trusts like the principal case were not taxable because "laws of the United States, or of any State or Territory" meant statutory enactments and did not comprehend organizations deriving their power from common law. The court correctly reasoned that such an organization would fall within the description of a "corporation" or "association" but for the restriction quoted.

This decision was perhaps not well reasoned, for, while "laws of the United States" does men statutory enactments, "laws of a State" includes both statutory and common law, and if this trust were organized within continental United States it must have been under the common law of a State or of the District of Columbia and hence within the description of the statute.

The ruling in Eliot v. Freeman would exempt de facto corporations and all associations not formed in compliance with statute, but as these would be taxed as partnerships the result would not be so bad.

Now, in the revenue act of September 8, 1916, the same language was used in section 407, referring to special taxes, but section 10, levying income taxes, used different language from that in the act of 1909. And in the act of October 3, 1917, the same is true as to section 10; that is, the language "organized under the law of the United States," etc., was changed to "* * * organized in the United States, no matter how created or organized * * *," but section 200, the excess-profits clause, used the old language.

The revenue act of 1918 and all subsequent acts have changed the old language for all corporation tax, so, from that time on, such an organization as the one discussed is taxable as a corporation; and it is likewise taxable under the 1916 and 1917 acts so far as relates to income tax. (Hecht *v.* Malley, supra.)

Since May 12, 1924, the courts are finally right on this question after 13 years of error perpetuated by faulty legislation and negligent administration.

Now comes the revenue act of 1924, passed after the above interpretation, and it uses both the old and the new language in the alternative, as follows:

"Sec. 2 (a) * * * (3) * * * created or organized in the United States or under the law of the United States or of any State or Territory."

This will settle the question provided the phrase "under the law of the United States" is ignored as meaningless, instead of being given its old construction.

What Congress has been trying to say for 15 years and what should be stated in the statute is this:

"Created or organized in the United States; or

"Created or organized without the United States if under any law of the United States or of a State or Territory."

In other words the statute does not intend to exempt operating trusts nor does it intend to require that organization must take place within the United States, but the language used has been construed prior to enactment and must henceforth be given the same construction even if clearly erroneous. The above amendment to section 2 (a) will correct the old errors and will be plain enough for the understanding of the Bureau of Internal Revenue.

The final point needing attention is the classification of trusts into those taxed as corporations and those taxed under section 219 as pure trusts. The fundamentum divisionis to be used for this purpose should have a legislative rather than an administrative basis.

The statute defines "corporation" as including "association" and the bureau is given the duty of dividing organizations into associations and pure trusts. This gives the bureau too much power and permits abuse of discretion such as occurred in the handling of the principal case.

In determining whether a business falls in the class of "association" when organized in trust form, very little aid is given by the courts, but the elements usually discussed are: (*a*) Was the trust formed to carry on a business for profit? (*b*) Were the beneficiaries associated in a common enterprise? (*c*) Did the beneficiaries have any control over the corpus or over the trustees? (*d*) Were the trustees associated like directors of a corporation? (*e*) Were the beneficiaries associated with the trustees? (*f*) Was the capital represented by shares?

It is generally conceded that (*a*) must be answered affirmatively. In Crocker *v.* Malley (39 Sup. Ct. 270, 249 U. S. 223) Justice Holmes indicated by dicta that (*b*) or (*c*) should be affirmatively answered. The decision in Hecht *v.* Malley, supra, held (*c*) not material.

It would seem that (*c*) should not be material because the organization is just as effective for business purposes and just as safe for the beneficiaries whether or not such control exists and because the beneficiaries can always control with the aid of an equity court. No consideration should be given to the question in (*d*) because there may be only one trustee and association thus readily avoided. The question in (*e*) should not be important because trustees as such can not be associated with beneficiaries, because technically they are distinguished by the rights held by the one group against the other. They have no rights in common. If the question in (*f*) is affirmatively answered it is of importance as an indication that (*a*) or (*b*) is answered likewise, but it is not controlling.

Article 1504 of Regulations 45 and 62 seems to hold the question presented in (*c*) as the controlling one, and there seems to be neither reason nor authority upon which to base such holding. Article 1504, Regulations 65, perhaps due to the decision in Hecht *v.* Malley, holds that (*c*) is not material. But this article demonstrates the folly of allowing an administrative bureau to legislate. It appears to make the question in (*d*) the all-important one, with the error above pointed out. Thus in the principal case the only change needful to make the organization not taxable as an association would be effected by resignation of one of the trustees, whereupon there could be no "association" of trustees.

Article 1502 of Regulations 65 further illustrates the fact that the bureau is still floundering hopelessly after 15 years of opportunity for improvement by evolution. This article states that—

"A corporation which has ceased to exist in contemplation of law but continues its business in corporate form is an association or corporation within the meaning of section 2, but if it continues its business in the form of a trust it becomes subject to the provisions of section 219."

This clause would seem made to order for corporations seeking to avoid tax by a change to the "form of a trust," as in the principal case.

The statistics are not available, but it has become common rumor that the trust form is a favorite means of tax evasion. It is suggested that Congress is the only power able to furnish a remedy. The following amendment is submitted for consideration:

"Sec. 2. (2) The term 'corporation' includes associations, joint-stock companies, and insurance companies; it also includes trusts organized or existing for the purpose of carrying on a business for profit the beneficiaries of which are engaged in a common enterprise."

Respectfully submitted.

F. B. Potter.

Treasury Department,
Washington, November 11, 1925.

Hon. James Couzens,
United States Senate, Washington, D. C.

My Dear Senator Couzens: Reference is made to the report of the agent of the investigating committee in the case of J. G. McCaskey and Louis Wentz, trustees, Ponca City, Okla.

The facts are substantially as stated in the above-referred-to report, namely, that prior to April 14, 1917, the Southwestern Oil Co., Ponca City, Okla., an Oklahoma corporation, operated certain oil leases in the State of Oklahoma. At a meeting of the stockholders on that date it was mutually agreed that the corporation should be dissolved and that the entire property and assets of the corporation should be turned over to trustees for the purpose of disposing of the assets, liquidating the liabilities, and turning the net proceeds over to the cestuis que trust. The resolution, in part, follows:

"Whereas it is the desire and intention of the stockholders of this the Southwestern Oil Co., a corporation, to dispose of its assets and wind up its affairs, liquidate its indebtedness, and dissolve its corporate existence."—Exhibit A, p. 2, par. 2.)

The resolution then continues:

"* * * that, as a means of accomplishing the above mentioned purposes, the board of directors of this corporation and its officers be and are hereby authorized, instructed, and directed to convey and assign by deed, assignment, and proper instrument of conveyance requisite to this end to J. G. McCaskey and Louis Wentz, of Pittsburgh, Pa., in trust, for the uses and purposes and with the powers hereinafter specified, all the following * * *." (Exhibit A, p. 2, par. 3. lines 5 to 14.)

Then follows the recital of the assets. Under the terms of the deed of trust the trustees are given power to receive the rents and profits accruing from the property during the life of the trust (art. 1); to manage and control said property during the life of the trust; to develop the wells and pay rentals and royalties from such wells; to invest funds coming into their hands for the acquisition of other wells; to purchase such materials and equipment as are necessary; to market the oil produced; to employ agents and laborers; to borrow money; to sell, at their discretion, any of the property conveyed to them by the trust instrument (art. 2); and to do all other things necessary to the full and complete exercise of the powers and rights granted them (art. 14). The trustees have no power to bind the shareholders personally; the trust property alone is to be liable for the debts. Profits are to be distributed to the shareholders from time to time in such amounts as are deemed reasonable in a businesslike management of the property and business in their hands under said trust (art. 2).

Article 3 of the deed of trust from the corporation to the trustees states:

"The period of this trust shall not extend * * * beyond the term of 15 years from the date of the trust deed herein authorized, and within that period the said trustees, or their successors, shall sell either at public or private sale on such terms as they deem proper, all the property then held by them in trust as herein provided, and after paying all outstanding obligations against the trust, distribute the proceeds therefrom and also all funds from any source to the shareholders as their interest appears * * *."

A provision then follows that if at the end of the fourteenth year all of the assets are not sold the trust may be extended for four years, if the owners of two-thirds of the beneficial interest in the trust agree thereto.

For the year 1917 a trust filed a return as an association, but subsequently protested and appealed to the committee on appeals and review, claiming that it should, for the year 1917, be taxed as a trust, the income of which is taxable to the cestuis que trust. In 1921 the committee on appeals and review, after referring the matter to the Solicitor of Internal Revenue and receiving an affirmative answer, decided in favor of the taxpayer, and the 1917 case was finally closed upon that basis in August, 1923.

The audit of the 1918, 1919, and 1920 returns then went forward upon the same basis. On February 9, 1924, the solicitor's office, in considering the certificates of overassessment proposed for 1918, returned the case to the unit with a memorandum stating that under the revenue act of 1918 the trust under consideration was a trust, the income of which was taxable to the trustees. The 1918, 1919, and 1920 cases were accordingly closed upon that basis, and on April 24, 1925, the trustees paid an additional tax for those years in the amount of $496,047.29. The cases were closed under section 1006 of the revenue act of 1924.

The issues raised in Mr. Potter's report are:

1. The bureau misstated and misinterpreted the facts.
2. The trust should have been taxed as an association or corporation.
3. The tax should have been paid by the trustees whether the trust was taxed as a strict trust or not.
4. The law is hazy and indefinite, thus permitting abuse of administrative discretion.

In considering the propriety of these charges it is necessary to consider the questions in the light of the prevailing law and rulings current at the time the decision was made.

Prior to May, 1924, when the decision in Hecht *v.* Malley (215 U. S. 144) was rendered by the United States Supreme Court, the primary test which was applied by the bureau in determining whether an organization operating under a trust instrument was a strict trust or an association, was the extent to which control was vested in the beneficiaries under the trust instrument. This test was not founded upon mere whim or caprice but was evolved through a series of court decisions and bureau rulings. (Crocker *v.* Malley, 249 U. S. 223, T. D. 2816, S. M. 1060, S. M. 337, S. 1205, S. O. 56, O. D. 407, O. D. 598-A, O. D. 620.)

Applying this test to the trust instrument under consideration, it is apparent that the beneficiaries of the trust did not have that degree of control which was considered necessary under the existing rulings to stamp as an association what purported to be a true trust. The beneficiaries had no power to terminate the trust, no power to remove the trustees, no power to declare dividends, no power to require a sale of the assets or any part thereof, no power to employ agents, servants or representatives to aid or assist the trustees, no voice in the management of the business, either directly or indirectly, or no supervision over the property or its management. As stated by the solicitor in his memorandum dated April 25, 1921 in this case:

"* * * there are but three possible provisions which can be construed as giving the beneficiaries any control, namely, the provision that the period of trust may be extended for four additional years with the consent of the holders of two-thirds of the shares; the provision for annual and special meetings of the shareholders; and the provision for the filling of vacancies in the trusteeship by the shareholders.

"It is difficult to see how the provision for the extension of the trust period can have the effect of placing control in the beneficiaries. In fact, if the power so granted is exercised it has quite the opposite effect by continuing the control of the property in the hands of the trustees for an additional four years.

"The provision in the instrument for annual and special meetings might have some significance if it appeared that the shareholders had authority to exercise any real control over the trustees or the conduct of the business at such meetings. But no such authority is granted, the entire control and conduct of the business being placed in the trustees elsewhere in the instrument. The trustees state that no such meetings have, in fact, been held, and that the shareholders exercise no control."

In view of these facts, how can it be charged that the bureau misstated the facts, or that the trust should have been held to be an association?

The original decision as to the status of the trust was made in 1921 and a final certificate of overassessment was issued in 1923. It is to be noted that such action as was taken relative to holding the trust to be a strict trust antedated May, 1924, the date of the decision in Hecht *v.* Malley. It was due solely to that fact that application was not made of the principle of the Hecht decision which, in substance, added to the category of associations, as then defined, a new group, namely, certain types of trusts in which the trustees were associated together for the purpose of engaging in business enterprises, whether or not the usual element of control by the beneficiaries existed.

Relative to the charge that the bureau misstated and misinterpreted the facts, it must be borne in mind that prior to May, 1924, the purpose for which a trust was formed was not deemed to be a relevant factor in determining its taxable status. It was therefore to be expected that prior to that time the facts as to the purpose for which so-called trusts were created should have been given little, if any, attention.

It is evident upon examination of the trust instrument under consideration that such instrument is practically analagous in all respects with the one considered by the Supreme Court in the case of Crocker *v.* Malley (249 U. S. 223). The decision in the Crocker case was approved by the same court in Hecht *v.* Malley, and is still controlling as to facts thereby presented. A comparison of that case with the case under consideration follows:

J. G. M'CASKEY AND LOUIS WENTZ TRUST DEED	CROCKER TRUST DEED
Trust was created by an Oklahoma corporation.	Trust was created by a Maine corporation.
There were transferred to the trustees the fee of certain lands leased to individuals, leaseholds, securities, etc.	There were transferred to the trustees the fee of certain lands leased to a Massachusetts manufacturing corporation engaged in operating several mills, and also the stock in that corporation which it held.
The expressed purpose of the trust was to convert this property into money, liquidate the liabilities, and distribute the net proceeds to the beneficiaries within 15 years from the date of the trust agreement.	The expressed purpose of the trust was to convert this property into money and distribute the net proceeds to the beneficiaries within a period left to the discretion of the trustees.
Meanwhile the trustees were to distribute the net income, from time to time, in such amounts as they saw fit, with the power to apply any funds to the repair, maintenance, and development of the property or in the acquisition of new property, prior to conversion and distribution.	Meanwhile the trustees were to distribute the net income, but could apply any funds for the repair and development of the property or the acquisition of other property, pending conversion and distribution. They could collect the rents and income with large discretion as to its application.

In the Crocker case the court held that there was no association, pointing out that no control over the trust was vested in the beneficiaries. This rule of control the bureau followed in determining the status of the McCaskey-Wentz trust, organized, as it was, under a trust instrument so closely resembling that of the Crocker trust.

In discussing the third issue raised in Mr. Potter's report, namely, "that even if this were a trust, the income should have been taxed to the trustees and not the beneficiaries," it is to be noted that the Income Tax Unit treated the income of the trust as taxable to the beneficiaries only for the year 1917, and that for the years 1918, 1919, and 1920 the case was audited and closed upon the basis of a trust, the income of which is taxable to the trustees. The difference in treatment resulted from the dissimilarity between the relevant sections of the 1916 and 1918 revenue acts.

The statement that the law is hazy and indefinite, thus permitting abuse of administrative discretion, would seem to indicate that the bureau has not followed a sound practice in disposing of questions arising in cases such as the instant one. This is not so, for as can be observed the bureau, with the assistance of the collector of internal revenue, has closely followed the decisions of the courts upon the subject.

Sincerely yours,

D. H. BLAIR, *Commissioner.*

MONUMENTAL BREWING CO.

[By Geo. G. Box, June 22, 1925]

OBSOLESCENCE ALLOWED FOR 1918

This taxpayer was engaged in the brewery business in Baltimore for many years prior to 1919. For the year 1918 the taxpayer submitted its income-tax return indicating a net income of $27,219.76 on which a tax of $2,951.29 was paid.

Under date of November 29, 1919, Revenue Agents W. C. Korb and F. C. McFerrin submitted a report of their investigation of the books and records of this taxpayer and recommended the assessment of an additional tax of $271,516.27. On February 26, 1921, the bureau mailed an A-2 letter to taxpayer indicating a proposed assessment of additional tax of $271,537.97 and a negligence penalty of $13,459.37 for 1918. The taxpayer filed a protest to the proposed additional assessment and was represented by the firm of Walker & Youngman, of Baltimore, Md. Subsequent to the receipt of the brief, the bureau prepared a letter to the taxpayer (Exhibit A) advising it that: "As Mr. J. M. Walker, while employed by the bureau as an agent, was engaged in the examination of income tax-returns filed by it for 1918 and prior years, and as it was contrary to the rules of the bureau to permit any former employee to appear before the bureau in any case of which he had any actual knowledge while in the service of the Government, this office can not receive him as the representative of your company, and the brief as submitted by Walker & Youngman can not be considered."

Under date of October 27, 1921, Mr. M. H. Wilhoite, chief section A, wrote a memorandum (Exhibit B) which he attached to the last above-mentioned letter in which he stated that this letter had been canceled in accordance with Mr. Alexander's instructions as the result of a conference between the latter and Mr. Walker, during which Mr. Walker assured Mr. Alexander that he had never had any connection with the case of the taxpayer while he was employed by the Government. It is significant that although the letter to the taxpayer was never mailed to it but was canceled, Mr. Wilhoite indicates by a lead-pencil note at the bottom of the copy of the letter in the files, that, "March 13, 1922. The original letter and first carbon which were with the case when it left section are missing on its return on the above-mentioned date."

Under date of September 30, 1921, revenue agents above mentioned filed another report in this case in which they stated:

"In conclusion we wish to state that Mr. J. M. Walker, of the firm of Walker & Youngman, was chief income-tax officer in this office in 1919, at the time this examination was made." (Reference is made to first examination mentioned above.) "He assigned the case to us for examination and advised us in connection with adjustments made in income and invested capital, and is therefore familiar with the case in every part. It is therefore our opinion that according to instructions contained in Order No. 31, dated November 15, 1920, Mr. Walker has no legal right to represent this corporation before the department in connection with the report covering examination of the years 1916 to 1918, inclusive."

Notwithstanding this report, signed by two agents who had been given instructions in this particular case by Mr. Walker, their chief, Mr. Alexander ignored their report and allowed Mr. Walker to represent the taxpayer on his personal assurance to him that he did not know of the case while he was in the employ of the Government. At this point it might be well to state that although the revenue agent in charge at Baltimore and the revenue agents who investigated this case protested vigorously against the action of the bureau, there seems to have been not only a lack of cooperation with them, but a failure to even advise them according to the usual practice of the status of the case.

During 1919 the corporation sold its capital assets at a loss of $388,096.45. The taxpayer contended that this loss should be allowed as a deduction from 1918 income under authority of section 204 (b), of the revenue act of 1918. The taxpayer also claimed a deduction of $212,168.99 obsolescence of good will. These contentions were allowed by the bureau, and under date of December 5, 1921, an A-2 letter was mailed to the taxpayer reducing the proposed additional assessment of $271,537.97 to $5,200. Under date of February 13, 1922, the revenue agent in charge, J. C. Wilmer, Baltimore, Md., wrote the bureau, from which the following is quoted: "The assessment letter is dated December 5, 1921, but was not received in this office until January 14, 1922, and I can not understand why such letter was not received in this office until 10 days after the expiration of the usual 30 day notice allowed taxpayers to make reply to assessment letters, it having been the department's practice in other instances to furnish the agent in charge with copy of assessment letters simultaneously with those furnished the taxpayers." On January 19, 1922, five days after the receipt of this letter by the revenue agent in charge at Baltimore, Revenue Agents Korb and McFerrin, representing him, called at the bureau to discuss the two principal adjustments which caused the large part of the divergency in tax proposed by the agents in their report and the additional tax of $5,200 which the bureau proposed to assess by its letter of December 5, 1921. They conferred with Messrs. L. E. Rusch, assistant chief; J. W. Manning, technical staff, and A. L. Draper, audit section "A," representing the consolidated returns subdivision. The report of this conference (Exhibit C) indicates that in their opinion the loss on the sale of the capital assets sustained in 1919 was not a proper deduction from 1918 income and that in regard to the matter of the deduction for obsolescence of good will, recommendation is made that the revised A-2 letter (revising letter of December 5, 1921) should be held up for a reasonable length of time in order that "if a supplemental report is furnished by the revenue agents on this point, its findings can be embodied in the letter above referred to."

Under date of February 13, 1922, the revenue agent in charge wrote the Commissioner of Internal Revenue (Exhibit D) setting out a résumé of the law and regulations from which he contended that the loss sustained by taxpayer from the sale of its capital assets in 1919 was not a proper deduction from 1918 income and that, as the company was not earning a 10 per cent return upon its tangible assets, it had no good will which could be capitalized under the authority of A. R. M. 34 (C. B. No. 2, p. 31). Under date of March 16, 1922, Mr. S. Alexander, head special audit division, wrote Mr. Chatterton, deputy commissioner (Exhibit E). He states that: "The first adjustment allowed in the amount of $212,168.99 for the obsolescence of good will for the year 1918, which deduction was not allowed by the agents in their original report, and which I understand is not now contested by the revenue agent." This statement is directly contrary to the facts, as the revenue agent in charge in his letter of February 13, 1922 (Exhibit D), states in the last paragraph: "In conclusion, in view of the most radical changes which have been made in the findings of the exami officers, and the fact that there appears to be no warrant for the allowance of a net loss in 1919, nor the allowance of obsolescence of good will, it is recommended that this case be carefully reviewed and the assessment letter to the taxpayer revised to show no allowance for either the application of net loss feature nor the allowance for obsolescence of good will." Mr. Alexander further states as follows: "Section 204 (a) states clearly and specifically that net loss refers to a loss resulting from the bona fide sale by the taxpayer of plant, building, machinery, equipment, etc., and I personally still claim that this is an allowable deduction under the net loss provision of the statute." In this sentence Mr. Alexander has omitted the qualifying clause of the statute which is of the greatest importance and which prohibits the bureau from allowing the deduction claimed by the taxpayer. Section 204 (b) provides that if any taxpayer has sustained a net loss between October 31, 1918, and January 1, 1920, it shall be deductible from the net income of the taxpayer for the preceding taxable year. Section 204 (a) in defining net loss states that term refers, "only to net losses resulting from either:

"1. The operation of any business regularly carried on by the taxpayer.

"2. The bona fide sale by the taxpayer of plant, buildings, machinery, equipment or other facilities constructed, installed or acquired by the taxpayer on or after April 6, 1917 for the production of articles contributing to the prosecution of the present war."

In other words, Mr. Alexander states in his memorandum that any losses sustained from the sale of plant, buildings, machinery, etc., in 1919 are deductible from 1918 income, whereas only losses from sale of such assets constructed, installed, or acquired by the taxpayer after April 6, 1917, for the production of articles contributing to the prosecution of the war are so deductibe. Mr. Alexander refers in his memorandum to Ruling I-5-50, IT 1179 (C. B. I.-1, p. 45). This ruling did not have the force of the regulations which were in effect at that time; was not in compliance with section 204 (a) of the act; and was overruled by I-37-434, IT 1421 (C. B. I.-2, p. 32).

Under date of March 18, 1922, the income tax unit referred the question of whether or not the loss sustained by the taxpayer in 1919 from the sale of capital assets was a proper deduction from 1918 income to the committee on appeals and review. The committee decided that the 1919 loss referred to was not a proper deduction from 1918 income.

Subsequently the taxpayer filed a brief contending, "That as the company ceased manufacturing in 1918, the brewery machinery and plant became obsolete and that the corporation is entitled to a deduction in 1918 for obsolescence of these physical assets as claimed in their original returns and rejected by the examiners."

Report (Exhibit F) dated April 20, 1922, of the conference held of J. W. Manning, technical staff, and A. L. Draper, section "A," with B. R. Youngman, attorney for taxpayer, states that the conferees are of the opinion that the company continued its operations into the year 1919 and are, therefore, not entitled to the deduction claimed for obsolescence in 1918 under the provisions of section 214 (b), article 143, of Regulations 45, but agreed, before finally disposing of the case, to grant the taxpayer's representative further time to submit additional information with respect to the matter.

Under date of November 24, 1922, the revenue agent in charge at Baltimore, Md., wrote the Commissioner of Internal Revenue (Exhibit G) referring to the original assessment letter of the bureau wherein the decision of the agents was overruled by the department calling attention to A. R. M. 185, "in which the committee on appeals and review sustained this office in its findings in connection with this case," and concluded as follows: "It appears, therefore, that the original assessment letter addressed to this company was in error and that a revised assessment letter will necessarily have to be submitted, showing this office sustained in both net loss and obsolescence features of this case As the settlement of this will establish a precedent in our examination of similar cases of breweries in this city, it is respectfully requested that I be furnished with a reply to this letter, advising as to the department's final findings in the case."

Under date of December 16, 1922 (Exhibit H) the bureau issued final A-2 letter allowing a deduction of $257,491.98 representing obsolescence of plant from 1918 income resulting in an overassessment for that year of the total original tax paid of $2,951.29. The amount of this obsolescence was deducted from the loss sustained through the sale of capital assets in 1919 the balance allowed as a deduction in 1919 with the result that the taxpayer had no net income for either year.

Under date of January 9, 1923, the revenue agent in charge at Baltimore, wrote the Commissioner of Internal Revenue (Exhibit I) referring to his letter of November 24, 1922, and urgently requested that he be furnished with a reply to that letter as the settlement of this case would establish a precedent in the examination of breweries in Baltimore.

This case is remarkable in view of the conflicting contentions made by the representatives of this taxpayer, and that, notwithstanding the vigorous protests made by the revenue agent in charge at Baltimore under whom the investigation of the returns was made, the taxpayer was finally allowed deductions palpably erroneous which were sufficient to relieve him of tax liability for the year 1918. In the first place in submitting the original return for 1918 this taxpayer claimed a deduction for obsolescence of plant and equipment. Obsolescence can be allowed as a deduction only when the plant has been closed or the use of all or a part of its equipment has been abandoned. Before such a deduction can be claimed for any given period it is essential that the use of the property should have been abandoned during that period or that it became certain that the property must be abandoned at a definite future date. (O. D. 1001 C. B. No. 5 P. 150.) As a result of an examination by the revenue agents this deduction was disallowed. Taxpayer's representatives then filed a brief admitting that it continued operations during the year 1919 for the manufacture of near beer up to the time the plant was sold. This claim was made in the hope that it could claim as an operating loss the loss from the sale of the assets in 1919 under section 204 (b) of the revenue act of 1918, and deduct same from the income for the year 1918. Subsequently a brief was filed claiming a deduction on account of obsolescence of good will. Both of these claims were rejected by the bureau. The next step of the taxpayer was to file a brief claiming that the plant ceased to operate on December 31, 1918, contradicting its former claim that it operated in 1919 when it had hopes of procuring a deduction on account of an operating loss for 1919. Regardless of the fact that the revenue agent in charge at Baltimore was on record as stating that the plant had operated in 1919, and the fact that the conferees in their report (Exhibit F) were of the opinion that the company continued its operations into the year 1919 which was based on evidence submitted by the taxpayer's representatives, including a copy of profit and loss statement for 1919, the bureau accepted the evidence submitted by the taxpayer that it ceased operations on December 31, 1918, and allowed it a deduction for obsolescence of plant and equipment in a sufficient amount to relieve it of tax liability for 1918.

Although there is a statement in the record by the revenue agents to the effect that Mr. Walker, while their chief, instructed them in regard to making the examination for the year 1918, Mr. Alexander, after a conference with Mr. Walker, instructed the cancellation of the letter to the taxpayer advising him that Mr. Walker could not represent it before the bureau. The record fails to show under what circumstances Mr. Walker called on Mr. Alexander at the identical time the letter was written, and before it was signed and dispatched.

The record shows that the internal-revenue agent in charge at Baltimore was most active in his endeavor to have this case settled on its merits, but it is very apparent that his activities were without avail.

The conflicting statements of the representatives of the taxpayer, in regard to whether or not it operated during the year 1919, deserved little consideration in view of the statement of the revenue agent in charge (Exhibit D) as follows: "The facts are that the company did continue in the manufactue of near beer, a business the similarity of which to the old business has been pointed out by the examining officers, and a business which would undoubtedly be to-day engaged in by the corporation, if it had not been presented with the opportunity of selling its assets to a corporation doing a meat-packing business, the control of which is vested in the same parties as were in control of the old company.

It is plain that there was no authority to allow this taxpayer a deduction for obsolescence in 1918 and that the only deduction it was entitled to on account of loss sustained from the sale of its assets was one from gross income for the year 1919. By allowing the deduction of obsolescence the taxpayer has avoided the payment of income tax for the year 1918 of $271,537.97, which was the proposed assessment indicated by the bureau's letter of February 26, 1921, and which is without doubt correct.

GEORGE G. BOX, *Chief Auditor.*

EXHIBIT A

MONUMENTAL BREWING CO.,
Lombard and Sixth Streets, Baltimore, Md.

SIRS: Reference is made to a brief from your representatives, Walker & Youngman, counselors in Federal taxation, in reference to an assessment letter to you dated February 25, 1921.

Mr. J. M. Walker, of the firm of Walker & Youngman, was formerly employed by the bureau as an internal revenue agent, and while so employed was engaged in the examination of the income tax returns filed by you and your affiliated companies for 1918 and prior years.

Under a ruling of the bureau no person who has ever been employed in the field service of the Internal Revenue Bureau will be permitted to appear before that bureau, or any of its field officers or employees, as attorney or in any other representative capacity in any matter whatsoever with which he had actually dealt or of which he had had any actual knowledge while in the service of the Government.

As Mr. Walker comes within the above-named class, this office can not receive him as the representative of your company, and the brief as submitted by Walker & Youngman can not be considered.

Respectfully,

DEPUTY COMMISSIONER.

This note appears at the bottom in pencil:

MARCH 13, 1922.

The original letter and first carbon which were with case when it left section are missing on its return on the above date.

(Signed) W. (WILHOITE).

EXHIBIT B

BUREAU OF INTERNAL REVENUE,
INCOME TAX UNIT, SPECIAL AUDIT DIVISION,
October 27, 1921.

In re: Letter to the Monumental Brewing Co., which has been withdrawn by Mr. Alexander.

The letter attached to this memorandum was handed to me by Mr. Bird, who, while in conversation with Mr. Alexander, was instructed by him to withhold it.

This decision was reached as the result of a conference between Mr. Alexander and Mr. Walker, during which the latter had assured him that he had never had any connection with the case while in the employ of the Government.

The letter, therefore, has been canceled in accordance with Mr. Alexander's instructions.

M. H. WILHOITE,
Chief of Section A.

EXHIBIT C

CONSOLIDATED RETURNS SUBDIVISION,
MEMORANDUM OF CONFERENCE WITH REVENUE AGENTS,
January 19, 1922.

In re: Monumental Brewing Co., Baltimore, Md.
Subject: Bureau's letter of December 5, 1921.

Revenue Agents W. C. Korb and F. C. McFerrin, representing the revenue agent in charge at Baltimore, Md., called to-day to discuss the two principal adjustments which caused a large part of the divergency between the additional tax of $287,065.28 for the years 1916 to 1919, inclusive, recommended by the field examiners, and the amount of $5,200 shown by the bureau's letter dated December 5, 1921, originating in this subdivision.

The consolidated returns subdivision was represented by Messrs. L. E. Rusch, assistant chief, J. W. Manning, technical staff, and A. L. Draper, auditor, Section A.

The first of these adjustments was a loss on the sale of capital assets of $388,096.45 sustained in 1919, due to the liquidation of the company, which was allowed to be deducted from 1918 income under section 204 (b) of the 1918 statute. The revenue agents contend that the unit overlooked section 204 (a) of the 1918 statutes when the loss on sale of capital assets was allowed under section 204 (b). Section 204 (a) states clearly that net loss refers only to loss resulting from the bona fide sale by the taxpayer of plant, building, machinery, equipment, or other facilities constructed, installed, or acquired by the taxpayer on or after April 6, 1918, for the production of the articles contributing to the prosecution of the present war. There is no question but that the resident auditor and reviewer in section A have overlooked this fact in connection with this case and that the contentions of the revenue agents are correct. For the above reason the loss due to sale of capital assets in 1919 claimed by the taxpayer can not be offset against the profits in 1918, and the letter of December 5, 1921, should be revised accordingly.

The second adjustment was in regard to the amount of good will allowed as a deduction in 1918 and 1919. The agents claimed that the basis used by this office is not in accordance with the facts, and they desired to make further investigation of the taxpayer's books and records in order to sustain their contentions. The figures used by this subdivision are contained in a brief dated July 14, 1921, submitted by the taxpayer in affidavit form. This brief was submitted to the revenue agent in charge at Baltimore and was returned with no comment on this particular point, leaving this office under the impression that there was no criticism of the taxpayer's contentions and figures. The revenue agents were also under the impression that this office should request the Baltimore office to check up the figures forming the basis for the obsolescence of good will allowance, which are set forth in the office letter of December 5, 1921. In as much as the taxpayer's brief containing the above-mentioned figures was submitted to the revenue agent in charge at Baltimore, and in view of the fact that two visits had already been made to the taxpayer's office for the purpose of ascertaining the correct tax liability, the conferees feel that no further steps should be initiated by this office to verify the taxpayer's figures. It is, however, recommended that the revised letter be held up for a reasonable length of time in order that, if a supplemental report is furnished by the revenue agents on this point, its findings can be embodied in the letter above referred to.

Interviewed by L. E. Rusch, assistant chief; J. W. Manning, technical staff; A. L. Draper, audit section A; Wm. P. Bird, chief consolidated returns subdivision.

EXHIBIT D

TREASURY DEPARTMENT,
INTERNAL REVENUE SERVICE,
Baltimore, Md., February 13, 1922.

Re: The Monumental Brewing Co., Baltimore, Md.
To: Commissioner of Internal Revenue, Washington, D. C.
Attention: Head field division.

Reference is made to copy of assessment letter A 2 (IT SA CR: A ALD 6751099), addressed to the above-named corporation, relative to the audit of my report dated November 30, 1919, covering examination of the tax liability of this corporation and its subsidiary, the Realty Holding Co., for the years 1916 to 1919, inclusive.

The assessment letter is dated December 5, 1921, but was not received in this office until January 14, 1922, and I can not understand why such letter was not received in this office until 10 days after the expiration of the usual 30-day notice allowed taxpayers to make reply to assessment letters, it having been the department's practice in other instances to furnish the agent in charge with copy of assessment letters simultaneously with those furnished the taxpayers.

On account of the most radical changes shown in the assessment letter as having been made in my report, I instructed the examining officers to take up with the reviewing authorities the question of such changes which had been made in my report to the benefit of the taxpayer. As a result of a conference held January 19, 1922, which the examining officers had with the auditors at Washington, Messrs. L. E. Rusch, J. W. Manning, and A. L. Draper, of the consolidated returns section, the conferees were unanimous in agreeing that an error had been made in reference to the net loss feature of the above-mentioned assessment letter.

I am transmitting herewith a communication submitted by the examination officers under date of February 13, 1922, wherein they respectfully take exception to the conclusions reached by the bureau with respect to the application of the net loss sustained in 1919 by the corporation, as well as to the allowance made to such corporation for obsolescence of good will.

NET LOSS, YEAR 1919

The application to 1918 income of a net loss arising from the sale of a business or ordinary business property in 1919 appears to be unwarrantable in the light of a close reading of section 204 of the revenue act of 1918. The law is most explicit in stating that such a loss refers only to (1) the operation of any business regularly carried on by the taxpayer; or (2) the sale by the taxpayer of plant, building, machinery, equipment, or other facilities constructed on or after April 6, 1917, for the production of articles contributing to the prosecution of the war.

It is the view of this office that the meaning of this section of the law is just what it says and that, if the lawmakers intended that a loss from the ordinary sale of a business or business property was to be considered in this connection, such lawmakers would have so stated, instead of limiting such losses to those arising from the operation of a business or those arising from property acquired subsequent to April 6, 1917, for production of articles contributing to the prosecution of the war.

In other words, a net loss to be allowable under this section of the law must arise from operation of business and by what is commonly known in accounting terminology as an operating loss, the only exception to this being that cognizance is to be given to such losses as may arise from sale of property acquired subsequent to April 6, 1917, for the production of articles contributing to the prosecution of the war.

The above is further emphasized by the department's own interpretation of the law embodied in article 1601, regulations 45, whereby the scope of losses is defined to be a "business-operating loss or a loss realized by the sale of property acquired on or after April 6, 1917, for production of articles contributing to the prosecution of the war."

Under authority vested in the Commissioner of Internal Revenue, by reason of the revenue act of 1918, the above-quoted regulation has the weight of the law itself until proven in the courts to be an incorrect interpretation of the law. Consequently, the term "net loss," as used in the law, means exactly the definition given to it in article 1601, regulations 45, or until such regulations is modified or rescinded.

My attention has been called to ruling IT 1179, 1-5-50, appearing in Bulletin No. 5, dated January 30, 1922, and promulgated subsequent to the above-mentioned conference, reading as follows:

"The term 'net loss' as used in section 204 of the revenue act of 1918 refers to a net loss attributable to the sale of capital assets as well as to operating losses, and may be deducted from the net income of a corporation for the preceding taxable year, provided the loss is of a kind referred to in section 234 (a) 4."

I call attention to the fact that there is no justification for the promulgation or issuance of the above-mentioned ruling in the absence of a Treasury decision modifying or rescinding article 1601, Regulations 45, which article, as above stated, has explicitly and in the clearest possible language defined the term "net loss," and which article, from a departmental standpoint, has the weight of the law itself.

The findings of the department in connection with the net loss feature of this case are so obviously at variance with the actual wording of the law, or inferentially the intent of the lawmakers, and likewise so manifestly at variance with the regulations, that no further comment relative to this item is deemed necessary.

OBSOLESCENCE OF GOOD WILL

For the reasons as have been clearly stated by the examining officers in their attached communication, it is extremely questionable if the company is entitled to obsolescence of good will under any consideration, and in this connection attention is invited to the fact that the actual conditions in this particular case do not meet with the following requirements enumerated in Bulletin F, page 140, reading in part as follows: "It must be shown that the good will will be of no value at the close of an approximately definite period, and that the taxpayer will be forced to discontinue business and be unable to continue in another similar business." The facts are that the company did continue in the manufacture of near beer, a business the similarity of which to the old business has been pointed out by the examining officers, and a business which would undoubtedly be to-day engaged in by the corporation, if it had not been presented with the opportunity of selling its assets to a corporation doing a meat-packing business, the control of which is vested in the same parties as were in control of the old company.

In supplement to the above, attention is invited to A. R. M.-34, reading: "No obsolescence or loss with respect to good will should be allowed, except in case of actual disposition of assets or abandonment of business." Here again the facts do not meet the department's regulations relative to the allowance of obsolescence of good will, for the reason that there was no actual abandonment of business at the time for which the company claims this allowance, for the reason, as heretofore stated, the company continued to engage in a similar business.

The taxpayer's representatives, in showing their method of computing the value of good will upon which obsolescence is claimed, have not followed the provisions of A. R. M. 34, and in recommending a method to be used for the purpose of calculating the value of good will as at a specific date the representatives have used a statutory net income instead of actual earnings, as per the company's books.

This office interprets the word "earnings," as used in A. R. M.-34, to mean profits or gains resulting from operation of taxpayer's business and out of which profits the taxpayer would pay dividends rather than meaning a statutory income figure not reflected in the company's profit-and-loss account and upon which no sane management would attempt to determine a good-will valuation, and neither permit the payment of dividends out of such statutory income.

The method followed by the taxpayer's representatives, in stating averaged earnings of this company as being the real earnings as taken from the company's books, plus adjustments necessary to reflect the net income figure prescribed by prior revenue acts, was so manifestly at variance with the wording of A. R. M.-34, that the agent in charge discussed this phase of the matter with Mr. A. L. Armstrong, chief, rules and regulations section, as to whether there was any justification for valuing good will upon the basis of a statutory income in the absence of ambiguous phraseology in such memorandum. The wording of the memorandum is, however, explicit in stating "earnings," and it is the view of this office, in which Mr. Armstrong concurs, that had the framers of the memorandum considered that there was any warrant for the use of a statutory income figure in determining good will they would have qualified the word "earnings" as used in the memorandum by stipulating that such earnings as used should be in conformity with the net income which should have been reported by the company under the revenue acts applicable to the respective years.

The method followed by the taxpayer's agents is likewise widely divergent with the suggestion in A. R. M.–34, in that an attempt has been made to capitalize the excess of net income over net worth or accounting capital in lieu of using tangible assets as a basis for the computation. Here again the authors of A. R. M.–34 would certainly have not used the positive wording "upon the average tangible assets," had it been their view that net worth, or accounting capital, was to be used as a basis for the computation. Unlike the representatives of the taxpayer, the examining officers have made no attempt toward deciding any debatable points in favor of either the Government or the taxpayer, but have definitely followed the provisions of the law and regulations, as well as the above-mentioned memorandum, and show in their attached communication the tangible assets for the five-year period, as taken from the taxpayer's books of account.

Collateral to the foregoing, it might be pointed out that, if it is proper for the taxpayer to base the value of good will upon a statutory net income, consistency would require that the tangible assets be shown in a like manner; that is to say, it would be necessary to show as tangible assets for the five-year period all such assets as had been improperly or erroneously charged off upon the company's books prior to and during such five-year period.

Ignoring this phase of the matter altogether, the examining officers have clearly shown, by following the real provisions of A. R. M.–34, that the company had no surplus earnings which were ascribable to the existence of good will. As a matter of fact, the company was not earning a 10 per cent return upon its tangible assets, and as a result any good will which it claims existed must, of necessity, have been extremely negligible and doubtful.

In conclusion, in view of the most radical changes which have been made in the findings of the examining officers, and the fact that there appears to be no warrant for the allowance of a net loss in 1919, nor the allowance of obsolescence of good will, it is recommended that this case be carefully reviewed and the assessment letter to the taxpayer revised to show no allowance for either the application of net loss feature nor the allowance for obsolescence of good will.

J. C. WILMER,
Internal Revenue Agent in Charge.

EXHIBIT E

MARCH 16, 1922.

MR. CHATTERTON:

As per your request, I am submitting herewith a résumé in connection with the Monumental Brewing Co. case, of Baltimore, Md.

In November of 1919 a revenue agent's report was submitted, for the years 1916 to 1918, inclusive, wherein additional tax of $287,065.28 was recommended. An A–2 letter was addressed to the taxpayer, under date of February 26, 1921, showing this additional tax, the unit concurring with the recommendation of the revenue agent. A brief was filed by the representative of the taxpayer, contesting the additional tax, and under our office procedure this brief was referred to the agents for verification and criticism, and with the request that the year 1919 be included in the reexamination.

After the return of the brief by the revenue agent, a revised A–2 letter was sent under date of December 5, 1921, and in which the tax shown to be due was $5,200.

The two principal adjustments which caused a large part of the divergence between the additional tax of $287,065.28, recommended by the field examiners in their original report and the amount of $5,200 shown by the bureau letter dated December 5, 1921, were the claim and deduction of obsolescence of good will, and a claim for the loss on the sale of capital assets. The first adjustments allowed in the amount of $212,168.99 for the obsolescence of good will for the year 1918, which deduction was not allowed by the agents in their original report, and which I understand is not now contested by the revenue agent. The second adjustment was a loss on the sale of capital assets of $388,096.45 sustained in 1919, due to the liquidation of the company, which was allowed to be deducted from 1918 income under section 204 (b) of the 1918 statute. The agents contend that the unit overlooked section 204 (a) of the 1918 statute when the loss on sale of capital assets was allowed in section 204 (b). Section 204 (a) states clearly and specifically that net loss refers to a loss resulting from the bona fide sale by the taxpayer of plant, building, machinery, equipment, etc., and I personally still claim that this is an allowable deduction under the net loss provision of the statute.

However, on account of the divergence of opinion in connection with this point, the case is being referred to the committee on appeals and review for an opinion and interpretation of this section, although we have at the present time a precedence that was established in Ruling I-5-50, IT 1179, which I believe covers the point at issue.

The files are being submitted herewith.

S. ALEXANDER,
Head Special Audit Division.

EXHIBIT F

CONSOLIDATED RETURNS SUBDIVISION,
TAXPAYER'S CONFERENCE.

Taxpayer: Monumental Brewing Co.
Address: Bath, Md.
Represented by: B. R. Youngman, attorney.

Matter presented.—The taxpayer's representative called in reference to new issues raised in a "third" or supplemental brief, dated March 9, 1922, filed after this case was referred to the committee on appeals and review for an opinion on the scope of the provisions of section 204 of the revenue act of 1918 as applied to losses embraced or included thereunder.

The committee on appeals and review made no examination of the case nor rendered any opinion on the question submitted in it, but returned the case to this section for consideration of the brief, filed as stated above, and the new issues raised therein.

In the said third brief, above mentioned, taxpayer now contends that as the company ceased manufacturing in 1918 the brewery machinery and plant became obsolete and that the corporation is entitled to a deduction in 1918 for obsolescence of these physical assets as claimed in their original returns and rejected by the examiners.

Conclusions.—From the evidence submitted by taxpayer's representative at the conference and from additional data, including copy of profit and loss account for 1919, and testimony presented by Revenue Agents W. C. Korb and F. C. McFerrin, representing the revenue agents in charge at Baltimore, Md., the conferees are of the opinion that the company continued its operations into the year 1919 and are, therefore, not entitled to the deduction claimed for obsolescence in 1918 under the provisions of section 214 (a), Article 143, of Regulations 45.

However, at the request of taxpayer's representative further time was granted to enable taxpayer to submit additional information and data with respect to this matter before it is finally disposed of.

Interviewed by—

J. W. MANNING,
Technical Staff.
A. L DRAPER,
Section A.
WM. P. BIRD,
Chief Consolidated Returns Subdivision.

APRIL 20, 1922.

EXHIBIT G

THE MONUMENTAL BREWING CO., BALTIMORE, MD.

INTERNAL REVENUE SERVICE,
Baltimore, Md., November 24, 1922.

COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C.:

Reference is made to copy of assessment letter (A-2), addressed to the above-named corporation, relative to the audit of my report dated November 30, 1919, covering examination of the tax liability of the above-named corporation, and its subsidiary, the Realty Holding Co., for the years 1916, 1919, inclusive.

Under date of February 13, 1922, this office, in taking exception to the above-named assessment letter, furnished the department with additional information relative to its findings in connection with an allowance of a net loss for the year 1919 and an allowance for obsolescence of good will, which findings had been overruled by the department, through the issuance of the above-mentioned assessment letter addressed to the taxpayer.

On account of the actual facts connected with this case being so widely divergent from the allowance which had been made by the department, and further, on account of the large amount of tax involved, I called the department's attention, under date of February 13, 1922, to the true facts in the case and submitted with my letter a communication, signed by the examining officers who made the investigation and who respectfully took exceptions to the conclusions previously reached by the bureau.

My attention has been invited to A. R. M.-185, appearing in Bulletin No. 45, dated November 6, 1922, wherein it appears that the solicitor has rendered an opinion in which the committee on appeals and review concurs, sustaining this office in its findings in connection with this case.

It appears, therefore, that the original assessment letter addressed to this company was in error and that a revised assessment letter will necessarily have to be submitted, showing this office sustained in both net loss and obsolescence features of this case. As the settlement of this case will establish a precedent in our examination of similar cases of breweries in this city, it is respectfully requested that I be furnished with a reply to this letter, advising as to the department's final findings in the case.

RAYMOND T. MILES,
Revenue Agent in Charge.

EXHIBIT H

DECEMBER 16, 1922.

STATEMENT OF RETURNS EXAMINED AND RESULTING TAX LIABILITY

The tax liability for 1917, 1918, and 1919, as shown in bureau letter of December 5, 1921, is confirmed. However, the following changes are being made in net loss for 1918 and 1919.

1918

Net loss, Schedule 11, bureau letter Dec. 5, 1921		$180, 151. 20
Net loss, 1919—not allowable (loss on sale of capital assets)		388, 096. 45
Balance, income		207, 945. 25
Less obsolescence, amount shown in Schedule 16, bureau letter Dec. 5, 1921	$257, 491. 98	
Less loss on sale of bonds included	5, 380. 27	
		252, 111. 71
Correct net loss		44, 166. 46
Tax liability		None.
Tax assessed		2, 951. 29
Applied against additional tax 1914, 1915, and 1916		727. 90
Overassessment		2, 223. 39

1919

Net loss, Schedule 18, bureau letter Dec. 5, 1921	$388, 096. 45
Less obsolescence allowed 1918	252, 111. 71
Corrected net loss	135, 984. 74
Tax liability	None.
Previously assessed	337. 58
Overassessement	337. 58

Certificates of overassessment will be issued through the office of the collector of internal revenue for your district and will be applied by that official in accordance with the provisions of section 252 of the revenue act of 1921.

EXHIBIT I

INTERNAL REVENUE SERVICE,
Baltimore, Md., January 9, 1923.

In re the Monumental Brewing Co., Baltimore, Md.

COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C.:

This office has had considerable correspondence with the department relative to the settlement of the above-named case.

Under date of November 24, 1922, I called attention to ARM–185, appearing in Bulletin 45, dated November 6, 1922, wherein it appeared that the solicitor had rendered an opinion on which the committee on appeals and review concurred, sustaining this office in its findings in connection with the case.

As stated in my letter of November 24, 1922, the settlement of this case will establish a precedent in our examination of breweries in this city, and I therefore urgently request that I be furnished with a reply to my letter of November 24, 1922, wherein I asked to be advised as to the department's findings in the premises.

RAYMOND T. MILES,
Revenue Agent in Charge.

NOVEMBER 12, 1925.

Memorandum for Mr. C. R. Nash, assistant to the commissioner.
In re Monumental Brewing Co., Baltimore, Md.

Reference is made to the criticism by the Senate committee relative to the manner in which the Bureau of Internal Revenue closed the case of the Monumental Brewing Co., Baltimore, Md., for the taxable years 1918 and 1919.

It appears that this taxpayer had been engaged in the business of brewing beer and owned and operated for that purpose a large plant situated in the city of Baltimore, and because of prohibition restrictions was forced during 1918 to cease operations, and on April 10, 1919, entered into an agreement for the sale of its property to the Jones & Lamb Co., meat packers of Baltimore, Md.

In its original 1918 income and profits tax return, filed June 14, 1919, the taxpayer deducted $318,492.28 as obsolescence on plant and equipment, stating that the plant had been sold for $311,000 and that active operations had ceased on December 31, 1918.

It is upon the allowance of $252,111.71 as obsolescence of plant and equipment in 1918 that the Senate committee makes the principal allegation of error and states that the allowance was made and the case closed contrary to O. D. 1001 (C. B. 5, p. 150).

The facts on this point are that in its original 1918 return the taxpayer claimed an obsolescence deduction of $318,492.28; the internal revenue agents who examined the taxpayer's books disallowed the deduction for 1918 and recommended a loss on the sale of the plant and equipment for 1919 instead; therefore the question presented was when did the taxpayer cease operating its plant?

It appears a settled principle under the ruling quoted by the Senate committee that if the plant was actually abandoned in 1918, or if it became certain that the plant must be abandoned at a definite future date, a deduction for obsolescence is allowable for 1918. This principle was also outlined by the committee on appeals and review in their recommendation No. 93, published in Cumulative Bulletin 2, page 142.

During a conference before the bureau there were presented by the taxpayer various books of account including the general ledger and the profit and loss accounts which reflected a liquidation of the business and not a regular business operation. There were no purchases in 1919 of ingredients used in the brewing of beer, and in January, 1919, the company began the dismantling of the machinery and equipment. A letter dated August 25, 1922, from the collector of internal revenue was exhibited in which the collector stated that according to his (the collector's) records the said company did not brew any beer after December, 1918.

In view of the fact that the taxpayer had presented positive proof of its contentions which were given the usual careful consideration, I am constrained to view the closing of the case proper and in accordance with the law and regulations.

C. B. ALLEN,
Assistant Deputy Commissioner.

NATIONAL ANILINE CHEMICAL CO.

(By Geo. G. Box, September 28, 1925)

Invested capital determination; made under advisory tax board recommendation No. 68; two years prior to decision of solicitor; dilatoriness; personal influence; former employees of bureau; consolidation; overassessment; tax payer relieved of payment of $3,000,000 in taxes.

Early in the year 1917 the Schoellkopf Aniline Chemical Works (Inc.) and the Becker Aniline & Chemical Works (Inc.) decided to acquire the Benzal Products Co., which was owned in equal proportions by the General Chemical Co., the Semet-Solvay Co., and the Barrett Co., and to form a new corporation which would absorb the assets of the first three above-named companies. This procedure was followed. The new corporation was incorporated in March, 1917, and named National Aniline & Chemical Co.

To complete this arrangement an agreement was entered into under date of April 5, 1917, by the six companies named above. The major steps in the performance of the agreement were as follows:

(1) Date of organization agreement, April 5, 1917.

(2) Date of ratification of organization agreement by stockholders of Schoellkopf and Becker companies, May 26, 1917.

(3) Date of filing charter of National Aniline & Chemical Co. (Inc.), May 26, 1917.

(4) Date of ratification or assumption of organization agreement by the National Aniline & Chemical Co. (Inc.), May 28, 1917.

(5) Date of actual transfer of properties to National Aniline & Chemical Co. (Inc.), i. e., delivery of blanket deeds by vendors, June 6, 1917.

(6) For convenience of accounting, the transfer on the new company's books shows the acquisition of the property as of July 1, 1917.

In considering the tax liability of the taxpayer for the year 1917, the Income Tax Unit originally decided that its taxable period was from January 2, 1917, to December 31, 1917. Subsequently the unit reversed its decision and held that the vendor companies were severally liable for the tax for the period January 2, 1917, to June 6, 1917, and the taxpayer for the period from June 6, 1917, to December 31, 1917. In considering the tax liability of the taxpayer it is also necessary to consider the tax liability of the vendor companies during the respective priods they operated during the year 1917 because the taxpayer agreed to assume the tax liability of the vendor companies for the period subsequent to January 1, 1917.

As the result of an audit made by J. G. Edwards, of the consolidated returns section of the Income Tax Unit, the tax liability of the taxpayer and the two principal vendors for the year 1917 was found to be as follows:

Schoellkopf Aniline & Chemical Co. (Jan. 2, to July 17, 1917), including profit on sale of assets	$9, 897, 623. 38
W. Beckner Aniline & Chemical Co., Jan. 2 to June 6, 1917	1, 376, 760. 44
National Aniline & Chemical Co., July 1 to Dec. 31, 1917	6, 283, 363. 43
Total tax liability	17, 557, 747. 25

The report of Auditor Edwards was finally disregarded by the bureau and the final settlement for 1917 of the last above-named companies showed a total tax liability (A–2 letter of June 27, 1922), as follows:

National Aniline & Chemical Co	$3, 136, 634. 29
Vendor companies	3, 582, 257. 86
Total	6, 718, 892. 15

This shows a reduction of nearly $11,000,000 in the recommendation made by Auditor Edwards.

The question involved in the determination of the tax liabiilty was whether the invested capital of the taxpayer for the year 1917 was limited by the provisions of section 208 of the revenue act of 1917, which are as follows:

"That in case of the reorganization, consolidation, or change of ownership of a trade or business after March 3, 1917, if an interest or control in such trade or business of 50 per cent or more remains in control of the same persons, corporations, associations, partnerships, or any of them, then in assscertaining the invested capital of the trade or business no asset transferred or received from the prior trade or business shall be allowed a greater value than would have been allowed under this title in computing the invested capital of such prior trade or business if such asset had not been so transferred or received, unless such asset was paid for specifically as such in cash or tangible property, and then not to exceed an actual cash value of the tangible property paid therefor at the time of such payment."

The records show that the Schoellkopf Aniline & Chemical Co., (Inc.), the principal vendor company, held the following interest or control in the new company after the final settlement under the organization agreement of April 5, 1917.

Total number of shares of preferred stock issued for assets as of June 6, 1917	193, 051
Total number of shares of common stock issued as of June 6, 1917	355, 990
Total shares issued or to be issued as of June 6, 1917, prior to cash subscription by General, Barrett & Solvay	549, 041
Total number of shares of preferred stock issued to Schoellkopf Aniline & Chemical Co. (Inc.) as of June 6, 1917	134, 258
Total number of shares of common stock to be issued to Schoellkopf under organization agreement	180, 468
Total shares to be issued Schoellkopf Aniline & Chemical Co. as of June 6, 1917	314, 726

$\frac{314{,}726}{549{,}041}$=57 per cent owned by Schoellkopf Co.

Total number of preferred and common issued for tangible and intangible assets of vendors as shown above	549, 041
Plus shares issued to General, Barrett & Solvay for cash subscription	38, 196
	587, 237
Total preferred shares issued to Schoellkopf Co	134, 258
Total common shares held by Schoellkopf Co. after contribution to common stock bonus paid the above three cash subscribers	145, 889
	280, 147

$\frac{280{,}147}{587{,}237}$=17 per cent owned by Schoellkopf Co. after cash subscription.

Preferred stock:	
193,051 issued for vendors' assets, at $100 par	$19, 305, 100. 00
38,196 shares issued for cash	3, 819, 600. 00
355,990 issued to vendors, book value $10.52243301 per share	3, 745, 880. 92
Total value of preferred and common stock after cash subscription of 38,196 shares, at $100 par	26, 870, 580. 92
Schoellkopf Aniline & Chemical Co. (Inc.) received:	
134,258 shares of preferred stock, at $100 per share	13, 425, 800. 00
145,889 shares of common stock, at $10.52243301 per share	1, 535, 107. 23

$\frac{\$14{,}960{,}907.23}{\$26{,}870{,}580.92}$=55 per cent interest owned by Schoellkopf Co. after cash subscription and contribution of common stock to bonus of cash subscribers.

The Income Tax Unit assessed taxpayer for the year 1917 on the basis that its invested capital was limited by section 208 above quoted. To this action taxpayer protested and filed a claim for abatement. The question was submitted to the Solicitor of Internal Revenue for his opinion. Solicitor Mapes decided in an opinion (unpublished)-

"That the limitations imposed by section 208 of the revenue act of 1917 apply in the computation of the invested capital of a corporation, firm, or a consolidation of several corporation (not originally affiliated) where the constituent corporations receive shares of stock of the new corporation in exchange for their assets and the several constituent corporations retained a control through stock ownership of 50 per cent or more."

The decision in question appears as Exhibit A of this report.

Notwithstanding the decisions of the solicitor, the Income Tax Unit settled the case on the ground that section 208 did not limit the invested capital which the taxpayer could claim for the year 1917, and as a result thereof issued certificate of overassessment No. 256698, showing an overassessment for the year 1917 of $3,035,771.55. Under the procedure of the Income Tax Unit the certificate was forwarded to the solicitor's office for examination before final action was taken thereon. It was returned to Deputy Commissioner Batson under date of June 9, 1922, by letter signed by J. C. Rogers, member committee on claims, with the following comment:

"The attached certificate of overassessment No. 256698, prepared for allowance in the amount of $3,035,771.55 in the case of the National Aniline & Chemical Co. (Inc.), of New York, N. Y., for the year 1917 has been examined.

"Approval is withheld for the reason that in making the adjustment upon which the certificate is based the limitations imposed by section 208 of the revenue act of 1917 have not been applied in a computation of the taxpayer's invested capital, in accordance with the opinion of the Solicitor of Internal Revenue recently submitted to the commissioner. However, it appears that, notwithstanding the opinion of the solicitor, the commissioner under date of May 27, 1922, advised the representative of the taxpayer that tax board recommendation 68 was considered to be controlling in this case and that the limitations imposed by section 208 of the revenue act of 1917 were not applicable. It is, therefore, presumed that the allowance will be scheduled without the approval of this office.

"Except as noted, above certificate is approved."

Notwithstanding the fact that the solicitor decided that section 208 of the revenue act of 1917 was applicable to this taxpayer in computing its invested capital for the year 1917, the Commissioner of Internal Revenue settled the case on the base that the said section was not applicable.

At the time the taxpayer was incorporated, stock of the par value of approximately $11,500,000 was issued to the vendor companies for the contracts, processes, and good will, intangibles which were not carried on the books of the vendor companies, and which if section 208 applied to this taxpayer could not be included in its invested capital. The unit decided as stated above that section 208 did not apply, so that the amount of the par value of the stock issued for these intangibles was allowed to be included in the taxpayer's invested capital. If this action was correct, the vendor companies were liable for income tax on the profit which they received upon the sale of these intangibles. In relation to this matter Solicitor Mapes in a memorandum to the commissioner said:

"The third question in this case is whether the several constituent corporations realized income at the time of the exchange from the transfer of their assets to the National Aniline & Chemical Co. in exchange for its stock. My opinion on this question was that the constituent corporations realized income from the exchange measured by the difference between the cost or value as of March 1, 1913, of the property and the market value of the stock received in exchange.

"I understand that the legal correctness of my opinion on this point is not questioned, but as a matter of policy it is deemed advisable to close the case on the other basis in accordance with which it has been prepared.

"This is a matter of policy concerning which I hesitate to express an opinion."

The vendor companies were not taxed on the profit made by them on the sale of the intangible assets above mentioned.

The certificate of overassessment in settlement of the 1917 tax was approved in June, 1922. In auditing the 1918 and 1919 returns, the tax liability for those years being still unsettled, it was necessary to examine the items which were allowed in computing the invested capital for the year 1917. As a result of this examination, James G. Leary, auditor of the Income Tax Unit, wrote to R. H. Lang, supervisor, under date of March 1, 1924, stating that he felt something was wrong in this case inasmuch as it was a Rossmore-McAdoo case and that in his opinion a revision should be made of the invested capital allowed by Rusch for 1917. (See Exhibit B.) (Francis H. McAdoo and E. E. Rossmore represent the taxpayer before the Income Tax Unit. The Rusch referred to is Mr. L. E. Rusch, formerly assistant chief of the consolidated returns division of the Income Tax Unit.) Under date of March 11, 1924, R. H. Lang, supervisor, wrote to James D. Leary in relation to this case, in which he stated that this is the case upon which Mr. Rossmore had been suspended and it is therefore essential that we get to the bottom of it. (See Exhibit C.) In a letter to Mr. Leary dated March 12, 1924, he recommends that every point passed upon by Mr. Rossmore as to allowance of invested capital be gone over very carefully and the basis gone over as well as the figures. (See Exhibit D.)

It is very evident that regardless of the decision of Solicitor Mapes, that the invested capital of this taxpayer for 1917 was limited by section 208 of the revenue act of 1917, yet the case was settled by the Commissioner of Internal Revenue under the authority of advisory tax board recommendation No. 68 dated September 29, 1919, rendered nearly two years prior to the decision of the solicitor, with the result that the taxpayer was relieved of the payment of approximately $3,000,000 in taxes.

Tax board recommendation No. 68 referred to above appears as Exhibit E of this report.

George G. Box, *Chief Auditor.*

Exhibit A

Department of Justice,
Office of the Solicitor of Internal Revenue,
Washington.

EXCESS-PROFITS TAX—SECTION 208 OF THE REVENUE ACT OF 1917

The limitations imposed by section 208 of the revenue act of 1917 apply in the computation of the invested capital of a corporation formed by a consolidation of several corporations (not originally affiliated) where the constituent corporations received shares of stock of the new corporation in exchange for their assets, and the several constituent corporations retained a control, through stock ownership, of 50 per cent or more in the new corporation, although the control retained by no one of the constituent corporations was 50 per cent or more.

Commissioner of Internal Revenue
(Attention Assistant Commissioner Smith):

My opinion has been requested on the following question which arises in connection with the case of the National Aniline & Chemical Co.:

Do the limitations imposed by section 208 of the revenue act of 1917 apply in computing the invested capital of a corporation formed by the consolidation of several corporations (not originally affiliated) where the constituent corporations received shares of stock of the new corporation in exchange for their assets but where the interest or control held by no one of the constituent corporations after the consolidation is as much as 50 per cent?

Section 208 of the revenue act of 1917 provides:

"That in case of the reorganization, consolidation, or change of ownership of a trade or business after March 3, 1917, if an interest or control in such trade or business of 50 per cent or more remains in control of the same persons, corporations, associations, partnerships, or any of them, then in ascertaining the invested capital of the trade or business no asset transferred or received from the prior trade or business shall be allowed a greater value than would have been allowed under this title in computing the invested capital of such prior trade or business if such asset had not been so transferred or received, unless such asset was paid for specifically as such, in cash or tangible property, and then not to exceed the actual cash or actual cash value of the tangible property paid therefor at the time of such payment."

In the case presented there was a consolidation of a trade or business after March 3, 1917, and the only doubtful point is whether "an interest or control in such trade or business of 50 per cent or more remains in control of the same persons, corporations, associations, partnerships, or any of them." This question may be approached from two angles:

If the trades or businesses of the several constituent corporations are regarded as one trade or business, the constituent corporations which collectively had a control of 100 per cent in the trades or businesses, retained through stock ownership that same control after the consolidation.

If the trades or businesses of the several constituent corporations are regarded as separate trades or businesses, then no one of the constituent corporations which had a control of 100 per cent in its own trade or business retained a control in such trade or business of 50 per cent or more after the consolidation.

It seems clear to me that the first view outlined above is the correct one. Section 208 deals only with the computation of the invested capital of the corporation resulting from the consolidation; it pertains to the trade or business of the new corporation and not to the trades or businesses of the constituent corporations. The trade or business consolidated is the entire trade or business of the several corporations, and the control of more than 50 per cent in this trade or business remains in the several constituent corporations.

The limitations imposed by section 208 apply to certain cases "if an interest or control * * * of 50 per cent or more remains in control of the same * * * corporations * * * or any of them." In the case presented a control of 100 per cent remained in the "corporations," although no one of the corporations retained a control in excess of 50 per cent.

The conclusion that the limitations imposed by section 208 apply in the case stated is entirely consistent with the intent of Congress as shown by that section. The quite evident congressional intent was to prevent the increasing of invested capital through corporate readjustments accomplished after March 3, 1917, the date of the approval of the first excess-profits tax. The reasons for such a limitation apply with equal force to cases of readjustment of the trades or businesses of several corporations as to cases of readjustment of the business of one corporation.

It is my opinion, in view of the above, that the limitations imposed by section 208 of the revenue act of 1917 apply in the computation of the invested capital of a corporation formed by a consolidation of several corporations (not originally affiliated) where the constituent corporations received shares of stock of the new corporation in exchange for their assets, and the several constituent corporations retained a control, through stock ownership, of 50 per cent or more.

The other inquiries submitted by you in connection with this case will be made the subject of a separate communication.

CARL MAPES,
Solicitor of Internal Revenue.

Approved: Commissioner of Internal Revenue.

EXHIBIT B

NEW YORK, N. Y., *March 8, 1924.*

Mr. R. H. LANG,
Supervisor Travel Unit, Consolidated Returns Audit Division,
Washington, D. C.

DEAR MR. LANG: You no doubt remember the waiver on National Aniline & Chemical Co. which was limited to next June under special agreement with Mr. Bright.

Well, I have the completed report of the case covering 1918 and 1919 and I regret to say that I don't want this report accepted. I feel that something is wrong, not on the part of Hallowell and Way (the auditors) but on the information furnished them.

This is a Rossmore-McAdoo case, and on the face of it it seems that a revision should be made of invested capital allowed by Rusch for 1917. I also think inventories of 1917, 1918, and 1919 should have more attention; also amortization claims.

Will you please see Mr. Lohman personally and state that I recommend a desk audit assessing a tax of at least $2,500,000 unless they file the usual waiver. Further, it would be best to let Mr. Bright know that apparently the company tried to rush the case through without giving reasonable time to allow consideration of the 1917 invested capital allowed by Mr. Rusch.

The writer feels assured that from a refund of $411,672.81 an additional tax will be secured.

Sincerely,

JAMES D. LEARY, *Internal Revenue Auditor.*

EXHIBIT C

MARCH 11, 1924.

Mr. JAMES D. LEARY,
Navarre Hotel, New York, N. Y.

DEAR MR. LEARY: In re National Aniline & Chemical Co., New York, N. Y.

I am inclosing a typed copy of your memorandum sent in pertaining to this case. I discussed this matter with Mr. Lohman and it was decided it would not be possible to make an assessment based upon an arbitrary office audit. The report is being returned to you via registered mail, and it is requested that the necessary examination be made and a report submitted thereon. The waiver gives until June 15 to make the assessment and we could put the assessment disclosed by the field investigation on the rolls without giving 30 days' notice, if such a step became necessary.

You have men available, and it is requested that the necessary examination be made. As stated in the confidential instructions, a copy of which was furnished each auditor some time ago, it is essential that we make the necessary check of the papers pertaining to a prior-year examination to ascertain whether or not the invested capital as used in the prior examination is correct.

It has also been stated that it is necessary to have a transcript of these analyses so that the invested capital used for the later years would be clearly set forth regardless of what was done in the earlier years.

* * * You state that incorrect information was furnished by the taxpayer. In such cases we would make an arbitrary disallowance of any items which could not be proven by the taxpayer.

For your information I will say that this is the case upon which Mr. Rossmore has been suspended, and it therefore is essential that we get to the bottom of it.

Sincerely,

R. H. LANG, *Supervisor, Travel Unit.*

EXHIBIT D

NEW YORK, N. Y., *March 12, 1924.*

In re: National Aniline and Chemical Co., New York, N. Y.

Mr. R. H. LANG,
Supervisor, Travel Unit,
Consolidated Returns, Audit Division,
Washington, D. C.

DEAR MR. LANG: Replying to your letter of March 11, 1924, relative to the above company, I have felt, as I wrote you Sunday, that they tried to put something over on Mr. Bright in this case by rushing it through, and I would not let it pass.

I recommend that every point passed upon by Mr. Rusch as to allowance for invested capital be gone over carefully, and the basis verified as well as figures. Further, that the method of rewriting the books of the company be looked into and commented on.

Special attention should be given amortization and inventories.

Sincerely,

JAS. D. LEARY,
Internal Revenue Auditor.

EXHIBIT E

ADVISORY TAX BOARD RECOMMENDATION NO. 68

Revenue act of 1918: Application of section 331 of the revenue act of 1918 to a corporation which issued its shares of stock to stockholders of other corporations in exchange for their shares of stock in such corporations.

SEPTEMBER 29, 1919.

The COMMISSIONER OF INTERNAL REVENUE
(For Assistant to the Commissioner, Callan).

The opinion of the advisory tax board is requested by the Income Tax Unit with reference to the application of section 331 of the revenue act of 1918 to the Union Carbide & Carbon Co., organized under the laws of the State of New York. A hearing was given to the corporation.

The following are the facts as understood by the board. They should, however, be verified before being acted upon. The Union Carbide & Carbon Co. was organized November 1, 1917, with an authorized capital of 3,000,000 shares of no par value stock. Four corporations were then in existence; the Union Carbide Co., the Prest-O-Lite Co. (Inc.), the Linde Air Products Co., and the National Carbon Co. (Inc.). The Union Carbide Co. owned about 35 per cent of the stock of the Linde Air Products Co. and about 40 per cent of the stock of the Prest-O-Lite Co. (Inc.). Other than these there were no intercompany stock holdings. Some individual stockholders owned stock in two or more of the corporations but, it is understood, only to a slight extent. The Union Carbide & Carbon Co. issued its capital stock for the stock of the corporations named on the following basis: Two and one-half shares for each share of the stock of the Union Carbide Co., two shares for each share of the stock of the Prest-O-Lite Co. (Inc.), three and one-half shares for each share of common stock of the Linde Air Products Co., and one share for each share of common stock of the National Carbon Co. (Inc.). By January 1, 1918, stock of these corporations had been deposited for exchange as follows: The Union Carbide Co., 95.38 per cent; the Prest-O-Lite Co. (Inc.), 99.7 per cent; the Linde Air Products Co., 98.38 per cent; the National Carbon Co., 90.9 per cent. A few of the stockholders of these corporations refused to exchange their stock and it was purchased for cash at varying prices by the Union Carbide & Carbon Co. The number of shares so purchased does not appear. The Linde Air Products Co. had outstanding an issue of nonvoting preferred stock and the National Carbon Co. (Inc.), an issue of voting preferred stock, but neither of these issues was acquired by the Union Carbide & Carbon Co. It does not appear whether this preferred stock was to any extent held by common stockholders of any of the corporations here under consideration. It is stated the the Union Carbide & Carbon Co. issued, prior to January 1, 1918, 1,929,774 shares. Apparently all of these shares were issued in exchange for stock as above set forth. After the exchange approximately the following percentages of stock of the Union Carbide & Carbon Co. were held by former stockholders of the other corporations: The Union Carbide Co., 48.5 per cent; the Prest-O-Lite Co. (Inc.), 9.5 per cent; the Linde Air Products Co., 21 per cent; National Carbon Co. (Inc.), 20 per cent. The Union Carbide & Carbon Co. did not acquire any of the assets formerly belonging to the other corporations. As above stated it acquired by exchange and purchase stock in such corporations. The result of the entire transaction was, therefore, the creation of a holding corporation holding the stock of four subsidiary corporations, stockholders of each of such subsidiaries having exchanged their stock therein for stock of the holding companies.

The question is whether in computing the invested capital of the Union Carbide & Carbon Co., or the consolidated invested capital of that corporation and its subsidiaries for the year 1918, the provisions of section 331 of the revenue act of 1918 are applicable, so that in computing such invested capital a reduction must be made from the value, at the date of the issuance by the Union Carbide & Carbon Co. of its capital stock, of the tangible property paid in therefor; that is, the stock of the subsidiary corporations, or in the case of a consolidated return, the assets represented by such stock. (See sections 325 (b), 326 (a) (2), revenue act of 1918, and article 868, Regulations, 45.)

Section 331 of the revenue act of 1918 is as follows:

"In the case of the reorganization, consolidation, or change of ownership of a trade or business, or change of ownership of property, after March 3, 1917, if an interest or control in such trade or business or property of 50 per centum or more remains in the same persons, or any of them, then no asset transferred or received from the previous owner shall, for the purpose of determining invested capital, be allowed a greater value than would have been allowed under this title in computing the invested capital of such previous owner if such asset has not been so transferred or received: *Provided*, That if such previous owner was not a corporation, then the value of any asset so transferred or received shall be taken at its cost of acquisition (at the date when acquired by such previous owner) with proper allowance for depreciation, impairment, betterment, or development, but no addition to the original cost shall be made for any charge or expenditure deducted as expense or otherwise on or after March 1, 1913, in computing the net income of such previous owner for purposes of taxation."

Whether or not this section applies to a specific case depends upon (1) whether there was a "reorganization, consolidation, or change of ownership of a trade or business, or change of ownership of property, after March 3, 1917," and (2) whether an "interest or control in such trade or business or property of 50 per centum or more remains in the same persons, or any of them." For convenience these questions will be considered in the reverse order.

Clearly "interest or control" in a trade, business, or property is not limited to direct ownership thereof. The direct ownership of the trade, business, and property of a corporation is, of course, in the corporation and not in its stockholders. The stockholders of a corporation, however, have an "interest or control" in the trade, business, and property of such corporation. Thus, before the transaction under consideration, the stockholders of each of the four corporations then existing had an "interest or control" in the trade, business, and property of their respective corporations. By the transaction the holding corporation acquired an "interest or control" in the trade, business, and property of the subsidiary corporations. The stockholders of the holding corporation then had an "interest or control" in the trade, business, and property of the holding corporation, and, through the medium of the holding corporation, in the trades, businesses, and properties of the subsidiary corporations.

The "interest or control" which is referred to in the statute is an "interest or control" in a trade, business or property as it existed prior to the "reorganization, consolidation, or change of ownership of a trade or business, or change of ownership of property." The statute applies only when an "interest or control" in such trade or business or property of 50 per cent or more remains in the same persons, or any of them." The word "remains" is important. It indicates that persons who had an "interest or control" in a trade, business, or property before the transaction, must retain an "interest or control" therein after the transaction if the limitation of section 331 is to apply. The extent of the "interest or control" which must be retained is fixed at "50 per cent or more." In the opinion of the advisory tax board the language of the section means at least that the limitation does not apply unless a person or group of persons who had an "interest or control" in a trade, business or property of "50 per cent or more" before the transaction retained after the transaction an "interest or control" in the same trade, business, or property of "50 per cent or more." This construction not only gives to the words their natural meaning, but also accomplishes the purpose of the section, which is to prevent an increase in invested capital by means of corporate readjustments which do not affect substantial rights.

From the facts before the board it appears that, after the transaction in question, no person or group of persons, other than those who were formerly stockholders of the Union Carbide Co., had an "interest or control" of "50 per cent or more" in the trade, business, or property in which, before the transaction, they were respectively interested. Thus, for example, substantially all of the stock of the Prest-O-Lite Co. (Inc.) was exchanged by its stockholders for stock of the Union Carbide & Carbon Co. The group of stockholders which before the transaction had an interest or control in the trade, business, and property of the Prest-O-Lite Co. (Inc.), of 100 per cent had after the transaction, through the medium of the holding company, an "interest or control" in such trade, business, and property of approximately 9.5 per cent—much less that 50 per cent. The former stockholders of the Linde Air Products Co. and of the National Carbon Co. (Inc.), are similarly situated. It follows that section 331 of the revenue act of 1918 is in no event applicable to the stock of such subsidiary corporations or the net tangible assets represented by such stock.

The situation with respect to the Union Carbide Co. seems to be different, though the decision with reference to this corporation depends upon facts slight changes in which would change the result. The group of stockholders therein who exchanged their stock for stock of the holding corporation secured an "interest or control" in the holding corporation of approximately 48.5 per cent and thus through the medium of the holding corporation retained 48.5 per cent of 95.5 per cent, or 46.3 per cent, of the trade, business, or property of the Union Carbide Co. The Union Carbide Co., was, however, a stockholder in the Linde Air Products Co. and the Prest-O-Lite Co. (Inc.), and by the exchange of stock in question acquired about 35 per cent of the stock of the holding corporation issued to the stockholders of the Linde Air Products Co., to wit, 21 per cent of the stock of the holding corporation, and about 40 per cent of the stock of the holding corporation issued to the stockholders of the Prest-O-Lite Co. (Inc.), to wit, 9.5 per cent. Since the holding corporation had by January 1, 1918, acquired 95.5 per cent of the stock of the Union Carbide Co. the result is that to that extent it retained an interest and control of its stock issued to the Union Carbide Co., or in effect retained in its treasury that percentage of its stock so issued. The stock so retained was, therefore, 95.5 per cent of 35 per cent of 21 per cent, and 95.5 per cent of 40 per cent of 9.5 per cent, an aggregate of 10.6

per cent, so that in substance the holding corporation issued only 89.4 per cent of its stock. Thus the group of stockholders of the Union Carbide Co., who before the transaction had an "interest or control in such trade or business or property" of 95.5 per cent, had after the transaction an "interest or control" therein of [illegible], or between 51 and 52 per cent. Consequently, an "interest or control" in the "trade or business or property" of the Union Carbide Co. of "50 per cent or more remains in the same persons, or any of them" within the meaning of section 331.

All the transactions here in question took place after March 3, 1917. It is unnecessary to decide whether any of the transactions, other than that between the stockholders of the Union Carbide Co. and the holding corporation constituted a "reorganization, consolidation, or change of ownership of a trade or business, or change of ownership of property, after March 3, 1917" within the meaning of section 331, since, as above pointed out, they are excluded from the application of section 331 for another reason. The transaction between the stockholders of the Union Carbide Co. and the holding corporation constituted a "reorganization." The word "reorganization" is used in the same sense as in section 202. As there used it is defined by article 1567 of regulation 45, as amended by Treasury Decision 2924, as follows:

"The term 'reorganization' * * * included cases of corporate readjustment where stockholders exchange their stock for the stock of a holding corporation, provided the holding corporation and the original corporation, in which it holds stock, are so closely related that the two corporations are affiliated as defined in section 240 (b) of the statute and article 633, and are thus required to file consolidated returns."

The holding corporation and the original corporation—that is, the Union Carbide Co.—are clearly so closely related that they are affiliated within the meaning of the statute, and are required to file a consolidated return. It is unnecessary to decide whether this transaction is within any other of the categories enumerated.

From the above considerations it follows that the provisions of section 331 of the revenue act of 1918 are applicable in computing the consolidated invested capital of the holding corporation and its subsidiary, or subsidiaries, with respect to the stock of the Union Carbide Co., or the assets represented thereby.

Since, with respect to the stock of the Union Carbide Co., or the assets represented thereby, section 331 of the revenue act of 1918 is applicable in computing invested capital, the method of its application must be considered. The section provided that:

"* * * No asset transferred or received from the previous owner shall, for the purpose of determining invested capital, be allowed a greater value than would have been allowed under this title in computing the invested capital of such previous owner if such asset had not been so transferred or received."

The only "asset transferred or received" is the stock of the Union Carbide Co. The holding corporation and the Union Carbide Co. are affiliated corporations and consolidated return is required. By article 868 of regulations 45 it is provided that—

"* * * the amount to be included in the consolidated invested capital in respect to the company acquired shall be computed in the same manner as if the net tangible assets and the intangible assets had been acquired instead of the stock."

Consequently, in computing the consolidated invested capital of the holding corporation and its subsidiary or subsidiaries, the "net tangible assets and the intangible assets" represented by the stock of the Union Carbide Co.; acquired by the holding corporation can not "be allowed a greater value than would have been allowed under this title in computing the invested capital" of the Union Carbide Co. if its stock had not been acquired by the holding corporation.

The interpretation herein given to the language "if an interest or control in such trade or business or property of 50 per cent or more remains in the same persons, or any of them" in section 331 of the revenue act of 1918 must be given to similar language in section 208 of the revenue act of 1917. It should be noted, however, that in other respects there are differences between the sections. It may be added that the conclusion herein reached under the later act would be reached on the same facts under the earlier act, and it is inferred, though not decided, that there is nothing in the facts with reference to the year 1917 which would lead to a different result with respect to the computation of invested capital for that year. (See Treasury Decision 2901.)

It is held, therefore, subject to verification of facts, that in computing the invested capital of the Union Carbide & Carbon Co. and its subsidiary or subsidiaries for the year 1918, the provisions of section 331 of the revenue act of 1918 are applicable to the extent that the "net tangible assets and the intangible assets" of the Union Carbide Co., represented by the stock therein acquired by the Union Carbide & Carbon Co., can not be allowed a greater value than would have been allowed in computing the invested capital of the Union Carbide Co. if the stock therein had not been transferred to the Union Carbide & Carbon Co., but that said section is not applicable to the stock of the other subsidiaries of the Union Carbide & Carbon Co. or the assets represented thereby.

J. E. STERRETT,
For the Advisory Tax Board.

Noted.

ROBERT N. MILLER,
Solicitor of Internal Revenue.

Accepted for the guidance of the Income Tax Unit.

DANIEL C. ROPER,
Commissioner of Internal Revenue.

PERSONAL SERVICE CORPORATIONS

[By Geo. G. Box, June 12, 1925]

REPORT ON SAME

To: Mr. L. C. Manson, general counsel.
From: Mr. George G. Box, chief auditor.
Subject: Personal service corporations.

Section 209 of the revenue act of 1917 provides as follows:

"That in the case of a trade or business having no invested capital or not more than a nominal capital there shall be levied, assessed, collected and paid, in addition to the taxes under existing law and under this act, in lieu of the tax imposed by section 201, a tax equivalent to 8 per cent of the net income of such trade or business in excess of the following deductions: In the case of a domestic corporation $3,000, and in the case of a domestic partnership or a citizen or resident of the United States $6,000; in the case of all other trades or business, no deduction."

The application of this section is provided for in article 71 of regulations 41 and is as follows:

"ART. 71. Application of section 209: Section 209 (see art. 15) applies primarily to occupations, professions, trades, and businesses engaged principally in rendering personal service in which the employment of capital is not necessary and the earnings of which are to be ascribed primarily to the activities of the owners.

"In determining whether a trade or business is taxable under article 15 no weight will be given to the fact that it is carried on by means of personal service unless the principal owners are regularly engaged in the active conduct of the trade or business."

In applying section 209, please note that the bureau has provided in Article 71 that a corporation will not be given a personal service classification unless the earnings are ascribed primarily to the activities of the owners and they must be regularly engaged in the active conduct of the trade or business if such classification is allowed. There seems to be no provision in the 1917 act authorizing the qualification made by the bureau in this article.

Respectfully submitted.

GEO. G. BOX, *Chief Auditor.*

PORT MORRIS HOLDING CO.

[By Geo. G. Box, June 16, 1925]

CONSOLIDATION AND AFFILIATION; NO DEFINITE RULE FOR AFFILIATION AND CONSOLIDATION

The taxpayer was incorporated August 1, 1919, for the purpose of consolidating the Winter Piano Co., of New York, Strauch Bros., of New York, and the Paterson Piano Case Co. of Paterson, N. J.

The taxpayer filed a consolidated excess profits tax return for the entire year of 1919, on April 13, 1920.

On April 20, 1921, Revenue Agent I. Levin submitted a report of his investigation of this taxpayer and stated that as it had no legal status prior to August 1, 1919, no authority existed for it to file a consolidated return for the seven months prior to that time. With his report he submitted one for each of the subsidiaries above named, from January 1 to July 31, 1919.

Under dates of September 10 and October 24, 1921, the bureau advised the taxpayer that it should have filed a consolidated income and excess profits tax return from the date on which it was incorporated, including each of the above-named subsidiaries from the date of acquisition of each subsidiary's stock by the taxpayer to December 31, 1919, and that separate returns should have been filed for each of the subsidiaries for the period from January 1, 1919, to the date of acquisition of their stock by the taxpayer.

By letter dated November 1, 1921, the bureau advised the taxpayer that in view of additional information presented in affidavit dated July 2, 1921, (Exhibit A) it was affiliated, within the purview of section 240 of the revenue act of 1918, with the Winter Co., Strauch Bros. (Inc.), and the Paterson Piano Case Co. for "the taxable year 1919 (from January 1 to December 31)." It also stated that this letter superseded office letters dated September 10 and October 24, 1921, referred to above. The affidavit referred to is one made by Max Alder, manager of the piano department of Sears, Roebuck & Co., who is a large stockholder of this taxpayer. In his affidavit he refers to an oral agreement, made in the year 1918, to form a holding company and hold all the shares of stock of the three companies above named; that such new company would take over the stock of the three companies as of January 1, 1919; that pending the formation of the new company no dividends be paid to stockholders of said three corporations on account of earnings after the year 1918 and that said new company should have the benefit as sole stockholder of said three companies after December 31, 1918, of all earnings, etc.

It appears that the claim of taxpayer to be considered affiliated for the entire year of 1919 is based solely on the oral agreement made by representatives of Sears, Roebuck & Co. and the subsidiaries named.

In January, 1923, A-2 letters were mailed to each of the subsidiaries advising them of their tax liability for the period from January 1 to July 31, 1919, and on January 29, 1923, the taxpayer was advised that it should have filed a consolidated return from the date it was incorporated to December 31, 1919. Protest of this action was made by the different companies, and in the protest of the Patterson Piano Case Co. its president states that—

"This matter was thereupon taken up at Washington by our tax counsel, and as a result of a conference held at Washington between our tax counsel and your committee on appeal the matter was adjudicated in favor of our original procedure, i. e., that the consolidated return as originally filed for the entire calendar year 1919 should remain in force."

The records fail to show that any such conference was held. However, C. H. Hill (who handles the tax matters of Sears, Roebuck & Co.) in his letter of October 28, 1921, states in part as follows:

"At that time a conference was requested to take up the matter of the date of the Port Morris consolidation, and I was informed that a decision had been made and my understanding was that this decision was favorable to us, and that a conference was unnecessary."

The letter of Mr. Hill is presented as Exhibit B.

The record shows that on April 18, 1923, the final ruling was made as follows:

"There is no doubt that the companies were not affiliated prior to July, 1919. But the ruling made after conference was relied upon by the taxpayer and from an administrative standpoint should be adhered to. Consequently the ruling embodied in bureau letter of January 1, 1923, is reversed and affiliation permitted for the whole year 1919. Authority and direction of Mr. Lohman, assistant chief consolidated returns subdivision. Ruling form signed by him".

This ruling was written by J. K. Polk, auditor, who was interviewed and stated that he did not think the ruling was correct. It was for that reason he insisted upon Mr. Lohman's O. K., and he stated that he assumed no responsibility for the ruling.

It is noted in the final ruling that it was made after conference was relied upon by the taxpayer. Attention is invited to the fact that the original return filed in 1920 was made on a consolidated basis long before the question of nonaffiliation for the first seven months of the year 1919 was raised at the conference.

The committee was advised that Mr. Hill was formerly employed in the Income Tax Unit. From the records it appears that Mr. Lohman and either Mr. Hill or some other representative of the taxpayer, reached an informal agreement that the corporations involved were to be considered affiliated for the entire year of 1919.

The tax paid by the taxpayer for the year 1919, under the ruling that it was consolidated with the above-named subsidiaries, was $19,895.63. The tax liability of the three subsidiaries from January 1 to July 31, 1919, on a separate basis and the taxpayer from August 1 to December 31, 1919, on an affiliated basis would have been $26,187.46, or $6,291.83 in excess of the amount which was paid on account of the erroneous ruling made in this case.

The correspondence which you forwarded to me is returned herewith.

Respectfully submitted.

GEO. G. BOX, *Chief Auditor.*

EXHIBIT A

STATE OF ILLINOIS,
County of Cook, ss:

Max Adler being sworn on oath deposes and says that he is manager of the piano department of Sears, Roebuck & Co., that during the latter part of the year 1918 he, together with Julius Winter, of Winter & Co., New York, N. Y., John W. Looschen, of Paterson Piano Case Co., Paterson, N. J., and Albert T. Strauch and William E. Strauch, of Strauch Bros. (Inc.), New York, N. Y., entered into an oral agreement to form a company which would substantially consolidate Winter & Co., Paterson Piano Case Co., and Strauch Bros. (Inc.); that such new company was to be a holding company and hold all the shares of stock of the three companies last above mentioned, and that such new company would take over the stock of said three companies as of January 1, 1919; that such company was thereafter formed in the year 1919 under the name of Port Morris Holding Co., and that the shares of stock of said three named corporations were transferred to said holding company; that it had been agreed in the latter part of the year 1918 between the said parties that pending the formation of the new company no dividends be paid to the stockholders of any such three corporations on account of any earnings or operations after the year 1918; further, that in the formation of the said holding company the stock of the various corporations was to be taken over on the basis of the value of such stock in 1918 and prior to January 1, 1919, and that it was the agreement and understanding between all the parties that the new company—that is, the holding company—should have the benefit as sole stockholder of said three companies of all earnings after December 31, 1918, and should be chargeable with any losses incurred thereafter; that in accordance with the terms of such understanding, the holding company being the main company, and the said three companies being subsidiaries, the holding company is bound to pay the Federal excess profits and income taxes for the entire year 1919 and thereafter, whether assessed against it or its subsidiaries.

Affiant further says that when said holding company was actually formed and the stock transferred to it, no dividends had been paid by any of said three subsidiaries on account of any earnings for the year 1919, nor were any of such earnings allocated to the former stockholders, nor was any credit allowed for any such earnings in fixing the value of the shares transferred to the holding corporation, but that such shares were taken wholly upon the understanding entered into in the year 1918 and upon the values agreed upon at that time. Affiant further says that it was understood between all the parties that the said consolidation was to be deemed effective as of January 1, 1919.

MAX ADLER.

Subscribed and sworn to before me this 2d day of July, 1921.

M. A. BERG, Jr.,
Notary Public.

EXHIBIT B

SEARS, ROEBUCK & CO.,
Chicago, October 28, 1921.

Mr. W. P. BIRD,
Chief, Consolidated Returns Subdivision,
Income Tax Unit, Washington, D. C.

DEAR SIR: Reference is made to undated letter to the Port Morris Holding Co., 863 East One hundred and forty-first Street, New York, copy of which was received by the writer October 27.

On account of the large holding of the stock in the Port Morris Holding Co. by Sears, Roebuck & Co., it has been decided that their tax matters should be handled by Sears, Roebuck & Co.'s tax department, of which the writer has charge, and he requests that in the future all communications on this subject be addressed to him in care of Sears, Roebuck & Co., Auditing Department, Chicago, Ill. Authority for this is now on file with the case in the department, the writer having presented same to Mr. B. A. Level, of the consolidated section, on October 20, 1921.

At that time, a conference was requested to take up the matter of the date of the Port Morris consolidation, and I was informed that a decision had been made and my understanding was that this decision was favorable to us and that a conference was unnecessary. We would like to know upon what ground the ruling was made that the consolidation should be made as of the date of the incorporation of the Port Morris Holding Co. As the agreement was made prior to January 1, 1919, that these companies should be operated as a unit from that date, as they were so operated, as the balance sheets as of December 31, 1918, were used as the basis of this consolidation and of the issuance of stock of the Holding Co., and as the making of the book entries and the incorporation of the Holding Co. were postponed from time to time awaiting the convenience of the manager of the factory department, who handles such matters, I can see no grounds for considering that the consolidation was effective from any other date than January 1, 1919. It has been our understanding that the controlling factor in any such case was not the mere book entries, but the actual intent of the contracting parties; and we have made affidavits to the effect that not only was the intent stated, but that agreements, both verbal and written, were made to this effect.

I therefore request that this decision be reconsidered and that we be advised of any additional facts desired by the department, and that we be given an opportunity of presenting our case in person, if this is absolutely necessary.

I also wish to call your attention to the third paragraph of the letter of July 2, a copy of which is inclosed, and request that a decision as to the good will be given.

Respectfully,

SEARS ROEBUCK & CO.
By C. H. HILL.

NOVEMBER 12, 1925.

Memorandum to Mr. C. R. Nash, assistant to the commissioner.
In re: Port Morris Holding Co., New York, N. Y.

Reference is made to the criticism made by the Senate Committee relative to the manner in which the Bureau of Internal Revenue closed the case of the Port Morris Holding Co., New York, N. Y., for the taxable year 1919.

It appears that the Port Morris Holding Co. of New York was incorporated August 1, 1919, for the purpose of consolidating the Winter Piano Co. of New York, Strauch Bros. of New York, and the Paterson Piano Case Co. of Paterson, N. J. The taxpayer filed a consolidated excess profits tax return for the entire year 1919 on April 13, 1920. Thereafter, on April 20, 1921, an internal revenue agent, after an examination of the taxpayer's books and accounts, submitted a report in which it was recommended that as the corporation (Port Morris Holding Co.) has no legal status prior to August 1, 1919, therefore no authority existed for it to file a consolidated income and profits tax return for the seven-month period prior to that date.

During a review of the internal revenue agent's report in connection with the question of the affiliated status of this company, there was filed an affidavit of one Max Adler for the purpose of placing before the bureau information in documentary form outlining the circumstances surrounding the formation of the company known as the Port Morris Holding Co. The affidavit, while not sufficient in itself to establish affiliation during the first seven months of the calendar year 1919, very strongly indicates the existence of the de facto corporation, and the acquisition thereby of the shares of the subsidiary companies, at some date prior to the actual completion of the legal technicalities of incorporating the new company and recording the transfer of the shares of stock of the underlying companies.

In view of the fact that the taxpayer presented evidence, orally and in documentary form, at conferences before the bureau which indicated the existence of the de facto corporation, I am constrained to view the closing of the case proper and in accordance with the law and regulations.

C. B. ALLEN,
Assistant Deputy Commissioner.

Ritz Carlton Restaurant and Hotel and Robert Walton Goelet

[By Geo. G. Box, July 11, 1925]

Option of Reporting Income on Accrual or Cash Receipts and Disbursements Basis

An examination of the returns of these taxpayers was made for the years from 1917 to 1920, inclusive.

Robert Walton Goelet was the owner of real estate located at the northwest corner of Forty-sixth Street and Madison Avenue, New York City. He entered into an agreement with the Ritz Hotels Development Co. (Ltd.), an English corporation, to erect a building suitable for a modern hotel on the above-mentioned site, and lease the building to the Ritz-Carlton Restaurant & Hotel Co., a domestic corporation organized by the Ritz Hotels Development Co., with the provision that it was to issue to him $750,000 of its capital stock for the lease, and in addition pay an annual rental of $540,000, payable monthly. The lease was signed in August, 1908. The hotel opened for business in December, 1910. In 1914 the hotel company was in arrears in the payment of its rent to the amount of $707,000. Mr. Goelet waived the arrearage on May 1, 1914, upon the payment to him of 40,000 shares of preferred stock of the hotel corporation, which had a par value of $5 per share. This stock was taken at its par value of $200,000, and the balance of the arrearage, viz, $507,000, was restored to surplus. At the same time a new lease was made under which Mr. Goelet agreed to accept a rental of $324,000 per annum with the provision that after the payment of annual dividends of 7 per cent on the preferred stock outstanding he was to receive an additional rent of $31,000 per annum plus one-half of the remaining profits.

He owned a majority of the preferred stock of the hotel corporation. He also owns 95 per cent of the stock of the Rhode Island corporation, a parent corporation, which is consolidated with seven subsidiaries. He is the owner and lessor of certain properties which are operated by some of the subsidiaries under leases to him. These leases provide for annual rentals payable monthly in advance. Accordingly, the various corporations charge on their books as rent the amounts stipulated in the various leases and claim deductions therefor from gross income in making their annual returns for income tax purposes. Notwithstanding the fact that the leases provide for the payment in advance to Mr. Goelet of these rentals, he has failed to collect any rent whatsoever from the various corporations since 1917, but has allowed the amounts to accrue to his credit on the books of the corporations.

He has made it a practice to submit his returns on the cash receipts and disbursements basis, and therefore under the regulations of the Bureau of Internal Revenue is not required to return as income any rentals which he has not actually received in cash. In addition to the rentals which have been accrued by the corporations they have from time to time accrued the interest due the lessor on the amount standing to his credit on their books, which they have also claimed as deductions from gross income in their returns, but which he has failed to return as it was not paid to him in cash.

The following shows the amounts accrued on the books of the various corporations which have been claimed by them as deductions and which have not been returned as income by Mr. Goelet:

1917

Rent:	
Hotel Walton Co., Philadelphia, Pa.	$75,000.00
Hotel Imperial Corporation, New York	20,000.00
Interest, Hotel Walton Co., Philadelphia, Pa.	30,842.12
Total rent and interest for 1917	125,842.12

1918

Rent:	
Hotel Walton Co.	$75,000.00
Hotel Imperial Corporation	120,000.00
Interest:	
Hotel Walton Co.	46,353.78
Hotel Imperial Corporation	7,735.73
Total rent and interest for 1918	249,089.51

1919

Rent:	
Hotel Walton Co	$75, 000. 00
Hotel Imperial Corporation	120, 000. 00
Goelet Realty Co	20, 583. 34
Interest:	
Hotel Walton Co	49, 629. 67
Hotel Imperial Corporation	15, 405. 49
Total rent and interest for 1919	280, 618. 50

1920

Rent:	
Hotel Walton Co	$75, 000. 00
Hotel Imperial Corporation	120, 000. 00
Goelet Realty Co	32, 730. 00
Interest:	
Hotel Walton Co	43, 593. 12
Hotel Imperial Corporation	18, 287. 05
Total rent and interest for 1920	289, 610. 17

RECAPITULATION OF INCOME

Rent and interest:	
1917	$125, 842. 12
1918	249, 089. 51
1919	280, 618. 50
1920	289, 610. 17
Total	945, 160. 30

This case illustrates the possibility of avoiding the payment of tax by a taxpayer who is the majority stockholder of a corporation under the present regulations of the Bureau of Internal Revenue which allow the taxpayer the option of submitting his returns on either the accrual or the cash receipts and disbursements basis. In this instance the tax on $945,160.30 income, received over a period of four years, has been avoided by Mr. Goelet due to the fact that he has not collected the amounts owing to him by the corporations above mentioned, of which he was majority stockholder.

In view of the fact that Mr. Goelet is a majority stockholder of the Ritz-Carlton Restaurant & Hotel Co., as well as owner of the property in which the latter operates, it is very questionable whether the extra rent provided in his lease, which is determined by the excess of the profits over the dividend requirements, should not be considered a distribution of earnings taxable to the taxpayer as dividends and not rental and allowable as a deduction as such to the corporation.

Respectfully submitted.

GEO. G. BOX, *Chief Auditor.*

TREASURY DEPARTMENT,
Washington, October 30, 1925.

HON. JAMES COUZENS,
Chairman Senate Investigating Committee.

DEAR MR. CHAIRMAN: Reference is made to the report of the representative of the investigating committee on the case of Robert Walton Goelet. The criticism contained in this report is, to quote from the report, as follows:

"This case illustrates the possibility of avoiding the payment of tax by a taxpayer who is the majority stockholder of a corporation under the present regulations of the Bureau of Internal Revenue which allow the taxpayer the option of submitting his returns on either the accrual or the cash receipts and disbursements basis."

I wish to point out that it is not the regulations of the Bureau of Internal Revenue which allow the taxpayer the option of submitting his returns on either the accrual or the cash receipts and disbursements basis, but the income tax law itself. In this connection I wish to call your attention to sections 200 (d) and 212 of the revenue act of 1924 and corresponding sections of prior revenue acts, as well as the decision of the Supreme Court in the case of Woodward *v.* United

States (256 U. S. 632). Since this matter is one of law and not regulations it can be changed only by legislative action. I feel sure, furthermore, that legislation which would prescribe strict and arbitrary methods for the accounting of all taxpayers would have such a disturbing effect upon the taxpayers of the country that its enaction would be unwise and its administration impossible.

Sincerely yours,

D. H. BLAIR, *Commissioner.*

RIVER RAISIN PAPER CO.

[By Geo. G. Box, Sept. 15, 1925]

COMPROMISE OF TAX LIABILITY AND PENALTIES

As a result of confidential information received by the Income Tax Unit an investigation of the tax liability of this taxpayer was made by a revenue agent for the years from 1916 to 1919. His report, dated June 17, 1920, recommended the following additional taxes, penalty, and overassessment:

Year	Additional tax	50 per cent fraud penalty	Overassessment
1916	$506.43		
1917	87,524.71		
1918	765,447.97	$382,723.98	
1919			$33,418.71
Total	853,569.11	382,723.98	33,418.71

Additional tax	$853,569.11
Penalty	382,723.98
Total	1,236,293.09
Less overassessment	33,418.71
Total liability to Government	1,202,874.38

The original taxes paid by the taxpayer was as follows:

	Tax		Tax
1916	$8,567.98	1918	$28,000.48
1917	189,355.72	1919	274,695.44

In his report the revenue agent states that the books of the taxpayer were in part destroyed and rewritten, and an attempt was made to evade taxation in the preparation of the 1918 returns. On account of this attempted evasion he recommends that a fraud penalty of 50 per cent of the additional tax for 1918 as well as the additional tax be assessed for that year. The record shows that Thompson & Black, tax specialists, were paid $75,000 by the taxpayer for the preparation of the return for 1918.

On June 15, 1920, the taxpayer requested that it be given a hearing before any additional assessment be made by the bureau.

On September 14, 1921, Deputy Commissioner Newton referred the case to the solicitor, requesting an opinion in regard to the assessment of the penalty recommended by the revenue agent.

Under date of October 4, 1920, Carl A. Mapes, acting solicitor, in a letter to Mr. Newton, sustained all the findings of the revenue agent and stated in part as follows:

"There appears no escape from the conclusion that the 1918 return was fraudulent, resulting in the fraudulent understatement of the tax due for the purpose of evading tax. The penalty of 50 per cent on the deficiency of the amount of the tax should therefore be assessed in accordance with section 250 (b) of the revenue act of 1918."

On December 6, 1920, a hearing was held in the office of the solicitor, the taxpayer being represented by the law firm of Ansell & Bailey.

On January 6, 1921, taxpayer submitted a set of briefs relative to each of the items disallowed by the revenue agent and requested a further hearing.

Under date of February 2, 1921, a memorandum was placed in the files signed by all the representatives of the Government present at the hearing of December 6, 1920 (who had considered the case both before and after the hearing took place), to the effect that the assessment should be made as originally recommended.

Under date of March 18, 1921, an A-2 letter was sent to the taxpayer advising him of additional taxes and 50 per cent fraud penalty for the years in question in the amount of $1,202,874.38 as recommended by the revenue agent.

Under date of March 22, 1921, attorneys for the taxpayer appealed from the proposed assessment as recommended, and requested an opportunity to make oral argument before the committee on appeals and review.

Under date of April 2, 1921, Carl A. Mapes, solicitor, wrote Acting Deputy Commissioner Batson in part as follows:

"The case was referred to the proving section under date of March 19, 1921, for an assessment of additional tax and penalty. As a result of conferences with the commissioner by Ansell & Bailey, the commissioner directed that the assessment be held in abeyance. Later he suggested to the solicitor that a further hearing be given the taxpayer and its attorneys (Ansell & Bailey)."

Subsequent to this hearing, which was held on April 11, 1921, the solicitor wrote an opinion to the deputy commissioner in which he disallowed all claims of the taxpayer, and in conclusion said:

"It is my opinion that the explanations and additional data presented by the taxpayer do not warrant this office in receding from its former position, and it is recommended that the original decision advising the assertion of the fraud penalty stand as made."

Under date of June 1, 1921, the taxpayer made an offer in compromise to the collector of internal revenue at Detroit, Mich., for all tax liability and penalties due from the year 1916 to 1919, inclusive, in the amount of $900,000.

Under date of August 17, 1921, the solicitor advised the collector at Detroit that the commissioner, upon the advice and consent of the Secretary of the Treasury, had accepted the compromise offer of the taxpayer.

Section 250 (b) of the revenue act of 1918 provides, in regard to the amount of tax shown in returns, in part as follows:

"If the understatement is false or fraudulent with intent to evade the tax, then in lieu of the penalty provided by section 3176 of the Revised Statutes, as amended, for false and fraudulent returns willfully made, but in addition to other penalties provided by law for false or fraudulent returns, there shall be added as part of the tax 50 per centum of the amount of the deficiency."

In this case the record shows the revenue agent recommended the assessment of the fraud penalty of 50 per cent for 1918. The solicitor on two different occasions recommended the assessment of this penalty, and, in addition, all of the representatives of the Government who appeared at the hearing of December 6, 1920, went on record to the effect that the assessment recommended by the agent, including the fraud penalty, should be made.

Section 250(b), above quoted, is very explicit as to the amount of the penalty to be assessed for the fraudulent understatement of tax due in returns.

The record fails to show that an examination of the financial condition of this taxpayer was made by a revenue agent at the time of the compromise offer, to ascertain if it was insolvent or unable to pay the additional tax and penalty found due.

The result of the acceptance of the compromise offer was that the fraud penalty was reduced from $382,723.98, the amount recommended by the revenue agent and solicitor, to $79,849.60, a clear loss of $302,874.38 to the Government.

GEO. G. BOX, *Chief Auditor.*

TREASURY DEPARTMENT,
Washington, October 30, 1925.

Hon. JAMES COUZENS,
Chairman Senate Investigating Committee.

DEAR MR. CHAIRMAN: Reference is made to the report submitted by the representative of the investigating committee with reference to the case of the River Raisin Paper Co. In this report the bureau is criticized for compromising the fraud penalty imposed upon the company for the year 1918. The basis of the criticism of the committee's representative is that "the record fails to show that an examination of the financial condition of this taxpayer was made by a revenue agent at the time of the compromise offer, to ascertain if it was insolvent or unable to pay the additional tax and penalty found due."

As representatives of the bureau have upon several occasions pointed out to the investigating committee, the Commissioner of Internal Revenue is authorized by statute to compromise fraud penalties. The severity of the fraud penalty, which was 100 per cent of the entire tax for 1917 and 50 per cent of the entire tax for 1918, shows clearly the necessity for vesting in the commissioner this authority to compromise. The policy of compromising these very heavy penalties for an amount which appeared reasonable in all the circumstances was established as far back as 1918 and has been consistently followed ever since. The compromise of the fraud penalty asserted against the River Raisin Paper Co. for $79,849.60 is just one of those cases where the commissioner, in accordance with the consistent policy of the bureau for many years, compromised the proposed penalty for an amount which in his judgment appeared reasonable considering all the facts and circumstances in the case.

Sincerely yours,

D. H. BLAIR, *Commissioner.*

SAXE, THOMAS; SAXE, JOHN E.; YELLOW CAB CO.

[By GEO. G. BOX, June 15, 1925]

OMISSION OF PROFIT ON SALE OF SHIP—TAX NOT PAID

SENATE COMMITTEE INVESTIGATING
BUREAU OF INTERNAL REVENUE,
INCOME TAX UNIT,
June 15, 1925.

To: Mr. L. C. Manson, general counsel.
From: Mr. George G. Box, chief auditor.
Subject: Thomas Saxe, Milwaukee, Wis.; John E. Saxe, Milwaukee, Wis. and Minneapolis, Minn.; Yellow Cab Co. (Inc.), Minneapolis, Minn.

An examination of the income of the above-named taxpayers for the years from 1917 to 1921, inclusive, has been made in accordance with the request of Senator Couzens. His memorandum of March 20, 1925, and letter to him from George J. Reid dated March 17, 1925, are returned herewith.

Thomas Saxe and John E. Saxe.—Revenue Agent A. P. West and Inspector Burt Wulff submitted a report of their investigation of these taxpayers under date of December 6, 1922, for the years from 1917 to 1921, inclusive. They state that the taxpayers "did not know themselves what was their financial situation nor what their incomes were. When they completed a transaction, the matter was then left to their bookkeeper, who oftentimes did not have a complete report of the details of the transaction."

They were interested in possibly 20 or 30 business enterprises, and it was necessary for the agents to investigate all of these companies. Several differences were found by the agents which resulted in a proposed assessment of additional taxes. These differences were protested by the taxpayers and finally reached the committee on appeals and review. This committee recommended a further investigation, and at that time the revenue agent in investigating the Miller Theater discovered that in 1916 these taxpayers sold their leasehold interests of the Miller Theater Co. at a profit of $50,000, which resulted in a net profit to each of $25,000.

This income was never reported by the taxpayers. They were requested to file amended returns for 1916, including the income derived from the sale of these leaseholds, but they refused to either sign amended returns or waivers as the statute of limitations had run. The additional taxes for 1916 would have been $885.68 for John E. Saxe and $872.51 for Thomas Saxe. As the statute does not run against fraud, the matter was referred to the solicitor, who decided that there was insufficient evidence to show fraud in the omission by the taxpayers to return this income, so that the additional taxes on the transaction in question were never paid.

At the present time there seems to be no authority in any of the revenue acts by which a taxpayer can be compelled to file an amended return, report his correct income, and be required to pay the correct tax in cases where a taxpayer omitted to report his correct income originally, if the statute of limitations has run, unless it is held that the original return was false and fraudulent. It is suggested that the committee recommend legislation to remedy this defect in the present law.

Yellow Cab Co. (*Inc.*).—There is no criticism to be made of the action of the Income Tax Unit in adjusting the tax liability of this taxpayer for the years from 1917 to 1920, inclusive. As a matter of information you are advised the records show that George J. Reid, the writer of the letter to Senator Couzens, which is returned herewith, was formerly employed as manager of this taxpayer.

Respectfully submitted.

GEO. G. BOX, *Chief Auditor.*

L. C. SMITH TYPEWRITER CO.; FLORA BURNS SMITH; BURNS LYMAN SMITH; FLORENCE BERNICE SMITH; UNITED BUSINESS CORPORATION

[By Geo. G. Box, June 20, 1925]

DEDUCTION OF CONTINGENT LIABILITY

Flora Burns Smith is the widow, and Burns Lyman Smith and Flora Bernice Smith the son and daughter, respectively, of Lyman C. Smith, formerly of L. C. Smith Typewriter Co., who died in 1910.

Revenue Agents J. B. C. Kelly and D. E. Dickson, in their report dated February 21, 1921, of their investigation of the income of Burns Lyman Smith, state that at the time of his death L. C. Smith owned 13,879½ shares of stock of the Hudson River Realty Co., and 165 shares of the 500 outstanding shares of stock of the Hudson Finance Co.

The Hudson River Realty Co., had vast holdings of real estate in Palisade, N. J. The Hudson Finance Co. was organized for the purpose of financing the Hudson River Realty Co. In 1905 the Hudson Finance Co. issued notes and L. C. Smith was the coindorser, with one Nottingham and one Beebe, thereof. When L. C. Smith died in 1910 the joint liability on these notes was approximately $300,000.

The Hudson Finance Co.'s assets were principally in mortgages of the Hudson River Realty Co.

Mr. Smith's estate consisted of about $10,000,000, which was divided equally among the above named taxpayers.

The contingent liability on the notes of the Hudson Finance Co. passed to the estate. In order that distribution of the estate might be made without delay, the heirs agreed amongst themselves that Burns Lyman Smith, the son, should take the place of L. C. Smith as an indorser of these notes and that the widow and daughter of the decedent would reimburse him for their share of any losses which might occur on account of the indorsement.

These notes ran along until 1914, when the banks began to demand payment. In the meantime the other coindorsers, Nottingham and Beebe, became financially irresponsible and Burns Lyman Smith had to take up the notes and pay the interest due on same. He continued doing so until in 1919 he had paid out $295,220.08 in redeeming notes and $35,683.18 accrued interest thereon.

In 1919 he sold the obligations above mentioned to Beebe, (one of the coindorsers), supposedly not financially responsible, for $50,000, and each of the three heirs of the L. C. Smith estate claimed in 1919 one-third of the loss, viz, $93,644.42, as a deduction from gross income.

The revenue agents state in their report that, "We have disallowed this loss to the individuals as it is clearly a contingent liability against the estate of L. C. Smith. They agreed to assume this liability merely for a matter of convenience to themselves; whereas had they not done so they would have received much less than they did receive from the estate."

The taxpayers protested the disallowance of the deduction representing the payments made on these notes and the matter was referred to the solicitor for his decision.

On May 4, 1922, Solicitor of Internal Revenue Carl M. Mapes, rendered a decision in which, after setting forth the facts in detail, he held that each of there three taxpayers suffered a loss of one-third of the total loss sustained in the transaction and that such losses are deductible under section 214 of the revenue act of 1918, in computing their respective net income for 1919.

In their report of February 21, 1921, of Burns Lyman Smith, the revenue agents recommended the assessment of a fraud penalty of $25,022.75. As the result of a protest made by this taxpayer to such action, Allen R. Stover, auditor of the special assignment section of the Income Tax Unit, filed a supplemental report under date of July 27, 1922, as a result of an investigation made by him of the income of the said Burns Lyman Smith, in which he refers to the solicitor's opinion above referred to as authority for allowing the taxpayer the deduction in 1919 of the loss occasioned by the indorsement mentioned.

Under date of March 1, 1924, Revenue Agent G. B. C. Kelley made a confidential report in which he stated that during most of the original examination Mr. Stover had been hostile to the taxpayer, but that suddenly one morning, after a game of golf with the taxpayer's attorney, he seemed to have changed his mode of procedure; "that his report bears very slight resemblance to the one we sent to him"; that his report sounds more like the brief of the taxpayer's attorney than the report of an official, and that "it has come to my attention from outside sources that the man who made the final adjustments in this case was at that time in the employ of the taxpayer or his attorney." The full report is attached as Exhibit A.

Mr. Stover, in his report of April 21, 1924, among other things, states that, "Revenue Agent Kelley's intimation that 'the man who made the final adjustments in this case was at that time in the employ of the taxpayer or his attorney,' if directed against me is too palpably ridiculous to merit comment. If his other criticisms can be measured by the same yard stick, they are deserving of the same slight consideration." His report is attached as Exhibit B.

In 1920, the United Business Corporation of America was formed for the purpose of taking over certain properties, both real and personal, owned by Mr. Burns Lyman Smith, its president and principal stockholder. The claim is made that the corporation was formed in order to avoid testamentary difficulties in the event of the death of Mr. Smith, who was then and is now the parent of two or three children, it being contended that the corporate form would permit more ready handling of the assets and liabilities of the principal stockholder prior to his death and also permit thereafter a more ready handling of the assets and liabilities of the estate of the deceased stockholder when represented by the corporate form so that the heirs would be safeguarded without possible sacrifices incident to the partition of the estate in any other form.

An examination was made of the United Business Corporations' income by David R. Rooney, revenue agent, and under date of February 9, 1924, he states in his report as follows:

"I will openly admit that the formation of this corporation is one of the most closed cases of an individual to escape the surtax on his personal return that I have ever come in contact with. It has been rumored around Syracuse that Mr. Burns Lyman Smith has made the remark that he had a method of his own in which he avoided paying large Federal income and excess-profits taxes, and I am of the opinion he had."

The income of the United Business Corporation of America for the year 1920 was included in the net income of Burns Lyman Smith by the bureau, in accordance with section 220 of the revenue act of 1918, and a proposed additional tax of $25,481.24 found due in accordance with subdivision E of section 218 of that act. Protest of the proposed tax was made by the taxpayer and the matter was referred to the solicitor for an opinion as to the applicability of section 220 to this income. The matter is still open.

In regard to the returns of Flora Burns Smith and Flora Bernice Smith, the only question criticized by the committee is the deduction in 1919 of the amount of $93,644.42 which each claimed as a loss through the indorsement by Burns Lyman Smith of the notes of the Hudson Finance Corporation mentioned above.

It is very evident that the indorsement by Burns Lyman Smith of the notes which his father had indorsed and on account of which there was a contingent liability against his estate, was made for the benefit of his mother, sister, and himself. In fact had this indorsement not been made, it undoubtedly would have delayed distribution of the assets of the estate, but there could have been no deduction from income of the beneficiaries of the estate on account of the indorsement in that event.

The claim is made that the Hudson Finance Co. had assets of $150,000 in excess of liabilities at the time of the death of L. C. Smith and that it could have paid off all its obligations at that time. Had it taken this course, however, the business of the Hudson River Realty Co. would have been affected; and as the Smiths were large stockholders in that corporation, their holdings would have decreased in value.

It is believed that a gross injustice to the Government is done by allowing the heirs of L. C. Smith to claim a deduction of over $93,000 from their income in 1919, as there seems to be no authority or law for such action, and that the bureau is subject to criticism in allowing Mr. Stover to make a reexamination of the income of Burns Lyman Smith after the letter of Revenue Agent Kelley, dated March 1, 1924, had been filed, accusing him of irregularities in connection with his former examination of the case.

Respectfully submitted.

GEO. G. BOX, *Chief Auditor.*

EXHIBIT A

SYRACUSE, N. Y., *March 1, 1924.*

W. P. HAYS, Esq.,
Internal Revenue Agent in Charge, Buffalo, N. Y.

In re Burns Lyman Smith:

Replying to yours of the 26th ultimo, inclosing copy letter IT:E:Aj-JWC, which letter requested that I prepare a report covering all my contentions in the above case, I beg to advise that such a report is almost impossible for reasons stated below, and, further, that if it were possible it would take weeks to verify statements in report of Stover. However, I will attempt to hit the high spots as best I can from the information at hand and from memory. You know I have no right to go to the taxpayer's records now for additional information unless fraud is evident and my conference was requested in order that one more capable than I might judge whether or not fraud could be proven, from the information at hand. In plain words here it is. It has come to my attention from outside sources that the man who made the final adjustments in this case was at that time in the employ of the taxpayer or his attorney. To make such a charge is too serious a matter for me to consider unless the department, with its many resources unknown to me, first will tell me if the information can be verified.

Referring to report of Allan R. Stover, fraud section; IT:SA:ARS:F-811.

First a report of our examination was submitted in February, 1921, and Stover came to Syracuse for a supplemental examination in September of that year. This supplemental was conducted by Stover and Agent Dixon and myself. During most of the examination Stover was more hostile than we had ever been, but suddenly one morning after a game of golf with taxpayer's attorneys he seemed to have changed his mode of procedure. He departed next day for Washington, leaving instructions for us to finish our computations and forward the report to him, which we did. His report, herein referred to, bears but very slight resemblance to the one we sent to him. Our report explained fully the contested items. His report sounds more like the brief of a taxpayer's attorney than the report of an official. In fact he allows deductions that the taxpayer's attorney didn't even suggest to us, and he invariably allows deductions that we disallowed with his concurrence at the examination. Our original report called for additional tax of $98,500 and our supplemental report which apparently met with his approval at the time did not cut much from this amount. His final report cut the additional assessment to $700 and, as I just learned to-day in collecting data from the collector's office, he further reopened the reports of Flora Burns Smith and of Flora Bernice Smith, which reports were never referred to the fraud section, and arbitrarily cut these assessments down. Also on the day that the information reached the collector's office regarding these reassessments amended returns were filed by them. It is also my information tha these returns were prepared by him, or at least from information set up by himt

. Specifically answering some of the statements in Stover's report above referred to:

Paragraph (a).—Additional tax liability referred to as $770.60 was the tax found by him and was incorrect. Our tax was $98,502.94 and, although subject to some revamping, was practically correct.

Paragraph (b).—This statement is absolutely false. The missing check book was not produced at the supplemental examination. Taxpayers did, however, produce schedules showing that some deposits were transfers and they were accepted as such.

Paragraph (c).—Not having my work sheets at hand, it is almost impossible to state the exact differences in rents received and the reasons for all additions. Of this much I am positive. The rents as shown per our report were as reported to us by Seattle agent in charge. We discovered a great discrepancy in taxpayer's books and had revenue agent in Seattle obtain the exact rents received, and it was on this discrepancy that we made one of our fraud claims. We didn't hear of this story of transferring amounts from one year to another at the time and I don't now believe it. It was properly 1919 income, fraud or no fraud, and I can't find where Stover has included it as income.

Paragraph (d).—Loss of $93,639.42. Stover quotes from the solicitor's opinion in this paragraph, and the opinion if actual is quoted from facts not at all as set forth by our report. In case it may be possible that our contention never came to the solicitor, I refer to our original report IT : SA : ZMS : P–811, dated February, 1921. In short, here is the case. Smith, together with one Nottingham and one Beebe, were joint indorsers on notes of an almost defunct corporation. Between date of making the indorsements and date of selling the notes both Beebe and Nottingham became financially irresponsible, leaving Smith as sole responsible indorser. Smith sells the notes (face over $300,000) for $50,000 to Beebe, one of the irresponsible indorsers and in turn takes nothing from Beebe. There may have been a note taken from Beebe, but it is my recollection that he sold on pure credit; at any rate nothing was ever paid on the acount or note up to the time of supplemental examination, September, 1920, and I believe Smith's books will show that nothing has been paid to date.

From the letter of Assistant Commissioner C. M. Justice it is noted that there is a suggestion about my being called to Washington in this matter. Nothing was further from my mind on making original report to you. The place for this conference would seem to be in Syracuse, where the facts may be verified before starting action.

———— ————,
Internal Revenue Agent.

MEMORANDUM.—The letter of the internal-revenue agent in charge at Buffalo, with which the above was transmitted to the bureau, calls attention to the fact that Revenue Agent G. B. C. Kelley inadvertently neglected to sign this report.

EXHIBIT B

MEMORANDUM

APRIL 21, 1924.

In re Burns Lyman Smith, 1045 James Street, Syracuse, N. Y.:

The following explanations and synopses are offered in rebuttal of the allegations contained in the unsigned confidential report of Revenue Agent G. B. G. Kelley, dated March 1, 1924, relative to a reinvestigation made by me on the basis of the accountants' reports and briefs submitted in protest against the original report of Revenue Agents D. E. Dixon and G. B. G. Kelley.

1916

The report of Revenue Agents D. E. Dixon and G. B. G. Kelley of December 18, 1920, shows no tax liability against Burns L. Smith for the year 1916. Their findings were verified during the reinvestigation and the details making up the gross income and general deductions, as contained in their report for this year, are accepted as correct.

1917

The noteworthy differences for this year are as follows:

Loss in block D increased from $35,767.90, as reported by the agents, to $86,357.56 by these adjustments.

Net loss on original report	$35, 767. 90	
Less additional rent found	42. 12	
		$35, 725. 78
Loss increased by additional depreciation allowed on L. C. Smith building and equipment, 1½ per cent on building value of $1,612,375.06	24, 185. 63	
Original report	18, 000. 00	
		6, 185. 63
Depreciation on equipment, 10 per cent on $415,954.87		41, 595. 49
Depreciation, painting, and decorating, 20 per cent on $13,856.50		2, 771. 30
Expense increased		79. 36
Total loss corrected		86, 357. 56

The additional depreciation allowed, $6,185.63 on building and $41,595.49 on equipment, are the former revenue agents' own figures as shown in their work sheets.

Dividends, from 1916 earnings, reported by the revenue agents in the amount of $29,983.75, were increased to $40,824.16 by the addition of dividends from the Smith Wheel Co., $631.09, and the Great Lakes Steamship Co., $10,209.32.

The allocation was made in accordance with a report of Revenue Agent J. M. Connolly, dated November 12, 1921, of his investigation as to the proper allocation of dividends paid by the Great Lakes Steamship Co.

This allocation is further substantiated by an affidavit furnished by H. W. Smith, treasurer of the Great Lakes Steamship Co., to the effect that the company had no earnings between December 17, 1916, and April 25, 1917, and the dividends paid upon its capital stock on April 1, 1917, was paid from earnings of the year 1916.

The revenue agents reported dividends from various sources from 1917 earnings in the amount of $92,797.71, which was reduced to the amount of $82,645.30 by the following adjustments:

Dividends reported by agents		$92, 797. 71
Less dividends of Smith Wheel Co., allocated to 1916	$631. 09	
Also dividends of Great Lakes Steamship Co., allocated to 1916	10, 109. 32	
		10, 740. 41
		82, 057. 30
Add dividends, Great Lakes Steamship Co., not reported		588. 00
Dividends, 1917, corrected		82, 645. 30

Other income in the amount of $99,603.14, reported in block H by the agents was decreased to the amount of $1,909.57 by the following adjustments:

Amount reported by agents	$99, 603. 14
Less bank deposits included by the agents	99, 150. 14
	453. 00
Add:	
Interest not found by agents	273. 99
Federal tax refunded	248. 00
Income unidentified	361. 45
Discounts and commissions, Seattle	134. 83
Interest received at Seattle	438. 30
Total income corrected	1, 909. 57

The bank deposits in the amount of $99,150.14, arbitrarily added to income by the agents, were analyzed and explained by the accountant in most instances and were shown to be transfers from one bank account to another and also included considerable amounts of money received from various persons to be invested or expended for them.

Receipts were recorded on the check stubs by name of payer, nature of the receipt and the amount thereof, the receipts so recorded being deposited immediately or from time to time in the various banks.

Disbursements made by check against the various accounts were described on the stubs in such manner that the nature of the disbursements could be readily identified.

The revenue agents comment on the bank deposits, at the time of my reinvestigation, as written on their work sheets at that time, reads as follows: "Balance income (bank deposits) accepted taxpayers amended."

1918

The income from rents in the amount of $20,004.37 as reported by the agents, which was decreased showing a loss in the amount of $31,575.95 by the allowance of deductions as shown below is the only material change between the income for this year as shown by the agents and my amended report.

Alterations on Mutual Life Building		$350. 59
Taxes on Mutual Life Building		48. 42
Additional expenses L. C. Smith Building		628. 82
Depreciation allowed on L. C. Smith Building:		
1½ per cent on building, $1, 612,375.06	$24, 185. 63	
Original report	18, 000. 00	
		6, 185. 63
Depreciation on equipment, 10 per cent on $415,954.87		41, 595. 49
Depreciation on painting and decorating, 20 per cent on $13,856.50		2, 771. 30
Total additional deductions		51, 580. 25
Income from rents originally reported		20, 004. 37
Total loss		31, 575. 88

1919

The material differences in this year are as follows:

Loss on sale of Mutual Life Building in the amount of $24,624.42 claimed by the accountant for the taxpayer. The loss of $11,393.70 as computed on this transaction by the agents appears correct and is allowed.

Income from rents in the amount of $85,983.27 as reported by the agents decreased to the amount of $34,434.18 by the allowance of additional deductions as follows:

Income originally reported by agents			$85, 983. 27
Less additional depreciation allowed on L. C. Smith Building, 1½ per cent on $1,612,375.06	$24, 185. 63		
Original report	18, 000. 00		
		$6, 185. 63	
Depreciation on equipment, 10 per cent on $415,954.87		41, 595. 49	
20 per cent depreciation on painting and decorating, $13,856.50		2, 771. 30	
Additional interest paid Mutual Life Building		587. 50	
Net additional expense allowed		409. 17	
			51, 549. 09
Net income from rents corrected			34, 434. 18

Other deductions increased from $5,000, as reported by the agents, to $98,634.42 on account of the allowance of $93,634.42 representing losses on notes of the Hudson Finance Co., which was recommended by the Solicitor of Internal Revenue in his memorandum dated May 4, 1922, pertinent excerpts of which only, are now quoted:

"The revenue agent disallowed these losses to the individuals on the ground that they were contingent liabilities against the estate of Lyman C. Smith and held that they agreed to assume these liabilities merely as a matter of convenience to themselves and that if they had not done so they would have received this much less from the estate of their father, Lyman C. Smith. This conclusion, however, overlooks the fact that at the death of Lyman C. Smith the assets of the Hudson Finance Co. were more than sufficient to pay off these notes.

"The liability of Lyman C. Smith's estate on the notes of the Hudson Finance Co. was that of accommodation indorser. When the banks which held the notes accepted Burns Lyman Smith as indorser instead of his father they, by that act, released the estate of Lyman C. Smith from all further liability. The debt was from that time the debt of the Hudson Finance Co., Burns Lyman Smith et al., indorsers, although Burns Lyman Smith was protected as to two-thirds of his liability by the agreement with his mother and sister to share equally with him any losses he might sustain. When the notes became due, Mrs. Flora Burns Smith took them up and held them as a liability against the corporation and the indorsers, two of whom had become insolvent. Mrs. Flora Burns Smith, however, was protected by Burns Lyman Smith's indorsement and by the agreement of Flora Bernice Smith to share one-third of the losses. The agreement with Burns Lyman Smith to the effect that he would share the losses with his mother and sister was a release by his mother of his liability as an indorser to her except as to one-third of any losses she might sustain.

"In view of the foregoing it is held that Burns Lyman Smith, Mrs. Flora Burns Smith, and Miss Flora Bernice Smith each suffered a loss of one-third of the total loss sustained in this transaction, and that such losses are deductible under section 214 of the revenue act of 1918 in computing their respective net incomes for 1919."

Revenue Agent Kelley's intimation that "the man who made the final adjustments in this case was at that time in the employ of the taxpayer or his attorney," if directed against me is too palpably ridiculous to merit comment. If his other criticisms can be measured by the same yardstick, they are deserving of the same slight consideration.

In reference to Mr. Kelley's statement regarding the hostile attitude I assumed toward the taxpayer's representatives during the early stages of the examination, I have only to say that this attitude was adopted by me in only one instance, which is explained as follows:

For several mornings at the outset of our examination we were kept in the attorney's office until 10 o'clock or later before the appearance of either the attorney or accountant. Finally, resenting this delay and the loss of time occasioned thereby, I emphatically informed Mr. Lewis P. Smith, the attorney, that in the future we expected their attendance promptly at 9 o'clock. This reprimand had the desired effect, and nothing happened subsequently to warrant any show of so-called hostility on my part.

He charges that my "mode of procedure underwent a change after a certain game of golf" which I played with the taxpayer's attorneys. My answer to this twaddle is that this game was played on a Saturday afternoon when the examination had practically drawn to a close, and my reason for leaving the early part of the following week was that there was no sound reason for remaining longer in Syracuse when my report could just as easily be compiled in Washington from work sheets in my possession which were prepared during the investigation.

Relative to his charge that the reports of Flora Burns Smith and Flora Bernice Smith were reopened by me and the assessment arbitrarily reduced, I have only to direct your attention to the accompanying letter signed by Internal Revenue Agent G. B. G. Kelley, in which he cites all three cases and with which he submits supplemental work sheets of all three cases proving that he knew at the time that all of these cases were pending in this section and were all receiving concurrent consideration, as was our general practice at that time; moreover, they were all affected for the year 1919 by the allowance of the losses in the Hudson Finance Co.

Exception is taken to Mr. Kelley's statement to the effect that my report "sounds more like the brief of a taxpayer's attorney than the report of an official."

My report was set up in this form for the purpose of showing the solicitor that the agent's allegations of fraud could not be substantiated with respect to any item with the possible exception of the loss in the Hudson Finance Co.

The determination in this instance was left to the discretion of the Solicitor of Internal Revenue, as is evidenced by the following quotation from my memorandum addressed to him January 30, 1922:

"The information the unit desires relative to this loss is principally as to whether or not it was a colorable transaction. During A. R. Stover's investigation a personal inspection of the payment in the form of notes was made, and it was found that less than $2,000 cash had passed between C. D. Beebe and Lewis P. Smith. The agent's contention that C. D. Beebe was financially irresponsible and is at the present time is true, and therefore it is the belief of this unit that, although the Smith's interests were mammoth, they would not release an obligation of approximately $300,000 and surrender to the said C. D. Beebe for a nominal sum their respective stockholdings of the Hudson Finance Co., and surrender and turn over the notes as aforementioned and any and all other indebtedness of any name and nature, due from said company to said Smiths for the sum of $30,000. Your opinion, together with any recommendations in the premises, is respectfully solicited."

In conclusion I might say that I am at a loss to account for Mr. Kelley's attitude in this matter and the malicious insinuations he has aimed at me so long after the final settlement of the case unless occasioned by a feeling of resentment against the taxpayer or his attorneys who, in their briefs and to me personally, complained of Mr. Kelley's actions during his and Dixon's investigation.

From the following it would appear that there was prejudice or ill feeling between the taxpayer, his attorney, and Mr. Kelley.

Under the preliminary statement of the brief of Flora Burns Smith, by D. R. Cobb, attorney for the executors, he states, speaking of the work of Mr. Nhare, their accountant: "In other words, his work has been that of an unprejudiced expert."

Intimations of Mr. Kelley seem to have made it necessary for the taxpayer to assure the bureau of his willingness to assist in the investigation, as follows:

"When he (Mr. Kelley) stepped in my office, he saw that I was in conference with several men. Two happened to be from out of town and the other was the vice president of our corporation. I interrupted the conference to ask Mr. Kelley what I could do for him and he pulled out a card showing his authority, and I then told him to go right to the office of Mr. Lewis P. Smith, attorney in the Onondaga County Savings Bank Building; that he was the one that knew all about my financial affairs and made the return on same; that he had all the papers and records right there I thought and if there were any lacking that Mr. Smith would be glad to procure them from my office; that I stood ready at all times to furnish to him complete information on any and all points that he might request. This was my attitude during the entire time that Mr. Kelley was engaged in examining my records, and on several occasions at the request of Mr. Kelley through Mr. Smith I sent records to his office. At no time have I attempted to or even thought of concealing or understating my income.

"No question was presented to me during the examination by the revenue officer that the required information was not furnished, and I supposed that his proposed report was made without leaving any question of importance unsettled or not explained."

In the course of the investigation I was called in Attorney Smith's private office, where he informed me that it became almost necessary at one time to forcibly eject Mr. Kelley from their office; he seemed to fear that Mr. Kelley whom he characterized as a loose talker might circulate any information of a confidential nature regarding the taxpayer's careless methods of handling all his business affairs.

His attitude is all the more mystifying because he and Dixon gave their tacit approval to practically all the adjustments save the one outstanding loss, which was largely responsible for the reduction of the tax liability as originally set up by the agents.

Respectfully submitted.

ALLEN R. STOVER,
Auditor, Special Adjustment Section.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, November 11, 1925.

Hon. JAMES COUZENS,
United States Senate, Washington, D. C.

MY DEAR SENATOR COUZENS: Reference is made to the report of the agent of the investigating committee criticizing the action of the bureau in the cases of Mrs. Flora Burns Smith, Miss Flora Bernice Smith, and Burns Lyman Smith. I am inclosing herewith for your information copy of the opinion of the Solicitor of Internal Revenue upon the basis of which these cases were settled and which states in full the reasons upon which the bureau's action was based.

In answer to the criticism of the bureau for "allowing Mr. Stover to make a reexamination of the income of Burns Lyman Smith after the letter of Revenue Agent Kelley, dated March 1, 1924, had been filed, accusing him of irregularities in connection with his former examination of the case," it is only necessary to state that the bureau did not allow, and Mr. Stover did not make, a reexamination of the case after the receipt of this report.

Sincerely yours,

D. H. BLAIR, *Commissioner.*

MAY 4, 1922.

Deputy Commissioner BATSON:

(Attention S. A. Alexander, head, specil audit division):

Reference is made in the file in connection with the cases of Burnes Lyman Smith, Mrs. Flora Burnes Smith, and Miss Flora Bernice Smith, of Syracuse, N. Y., and to your memorandum of January 30, 1922.

Lyman C. Smith died November 5, 1910, intestate, leaving surviving him his wife, Mrs. Flora Burnes Smith; his son, Burnes Lyman Smith; and his daughter, Miss Flora Bernice Smith. At the time of his death he was accommodation indorser on notes of the Hudson Finance Co. in the approximate sum of $305,750.

After his death his son, Burnes Lyman Smith, signed the notes in place of his father. When the notes became due Mrs. Flora Burnes Smith advanced the money with which to pay them but did so under an agreement that Burnes Lyman Smith and Flora Bernice Smith would share equally with her any losses sustained. Under this agreement Burnes Lyman Smith and Flora Bernice Smith each paid to Mrs. Flora Burnes Smith in 1919, $92,634.42, as their share of the loss sustained. Your request an opinion as to whether these losses are deductible losses within the meaning of section 214 of the revenue act of 1918 in computing the net income of the taxpayers for the year 1919.

The Hudson River Realty Co. was a corporation owning large tracts of real property on the Palisades, in the county of Bergen, State of New Jersey. The Hudson Finance Co. was organized in the year 1906 by William Nottingham, Clifford D. Beebe, Lyman C. Smith, and Albert G. Hiscock, for the purpose of giving financial aid and assistance to the Hudson River Realty Co. The capital stock of the Hudson Finance Co. consisted of 500 shares of the par value of $100 each. At the date of Lyman C. Smith's death, the Hudson Finance Co. had notes outstanding aggregating approximately $391,000 and had assets estimated to be worth $150,000 in excess of its liabilities. Lyman C. Smith, William Nottingham, and Clifford D. Beebe were coindorsers of the company's notes to the extent of approximately $305,750. The Hudson Finance Co. having been organized for the purpose of furnishing financial assistance to the Hudson River Realty Co. during the period of development of its property, a speedy disposition of the property of the Hudson Finance Co. would have greatly interfered with the development of the Hudson River Realty Co.'s property and entailed a sacrifice of values to both companies.

At the death of Lyman C. Smith he owned 165 shares of the capital stock of the Hudson Finance Co., which was appraised at $75 per share, and 13,879½ shares of the Hudson River Realty Co. In view of the fact that a speedy disposition of the assets of these two companies would have entailed a considerable sacrifice, William Nottingham and Clifford D. Beebe, who were coindorsers with Lyman C. Smith on the notes above referred to, and who were also stockholders in both companies, requested Burnes Lyman Smith, the son and one of the heirs of Lyman C. Smith, to lend his credit to the Hudson Finance Co. by taking his father's place as accommodation indorser upon the Hudson Finance Co.'s paper. He consented to do this but had an understanding with Mrs. Flora Burnes Smith, and Miss Flora Bernice Smith that they would share with him any losses sustained by reason of his indorsement of the Hudson Finance Co.'s paper. Burnes Lyman Smith began to indorse the Hudson Finance Co.'s paper in 1911, continuing to do so until he had taken his father's place on substantially all the paper which Lyman C. Smith had indorsed prior to his death. Clifford D. Beebe and William Nottingham were also liable as indorsers on the same paper.

In the meantime it appears that Mr. Beebe and Mr. Nottingham became financially irresponsible and when the notes became due Burnes Lyman Smith appears to have been the only solvent indorser. Due to the financial stringency caused by the outbreak of the World War in 1914, another company which owned a large area of land adjacent to the Hudson River Realty Co. became insolvent and a great number of lots were thrown on the market at prices much lower than the prices the property had been selling for and the forced selling of adjacent lots caused such a depreciation in market value of the Hudson Finance Co.'s property and securities that the bankers called their paper. The payment of these notes out of the assets of the company at that time would have entailed great sacrifices but it appeared that the company would be able by slow liquidation to satisfy all of its debts and make some payment on its capital stock. Accordingly, Mrs. Flora Burnes Smith agreed to advance the money to the Hudson Finance Co. with which it could pay off the notes, and Flora Bernice Smith and Burnes Lyman Smith agreed that if she did so they would each bear their part of any losses sustained. She began to advance the money in 1914 and by 1919 had advanced $330,903.26. At that time she called upon her attorney, Mr. Lewis P. Smith, to investigate the affairs of the Hudson Finance Co. with a view to disposing of her holdings in said company. In compliance with her request, Mr. Smith made a careful examination into the assets and financial condition of the Hudson Finance Co. and negotiated with Clifford D. Beebe a sale of all the notes of the Hudson Finance Co., aggregating $300,000, for $50,000 to be paid in monthly installments during 1919, with the further understanding that after the $50,000 had been paid the shares of stock in the Hudson Finance Co. then held by the heirs of Lyman C. Smith would be transferred to Clifford D. Beebe for a consideration of $1. There is no evidence that this was not a bona fide sale, free from fraud. It was induced by the fact that the assets of the Hudson Finance

Co. consisted of unimproved real estate, some of which was mortgaged and upon which there had accrued unpaid taxes and interest amounting to more than $30,000, with the result that the taxes together with interest charges and office rent would soon have consumed the value of the assets. Mr. Beebe paid the $50,000 during the year 1919 with the exception of a small amount which was paid by February, 1920, and the stock of the Hudson Finance Co. was transferred to him according to the contract.

Lyman C. Smith died intestate, and upon his death Mrs. Flora Burnes Smith, his wife, was appointed administratrix of his estate. The estate was administered and the decree of the surrogate's court of Onondaga County, N. Y., was entered July 8, 1912, distributing the estate and discharging the administratrix. The funds advanced by Mrs. Flora Burnes Smith to the Hudson Finance Co. were advanced from 1914 to 1919 out of her personal funds. The settlement between Flora Burnes Smith and her two children was had in 1919, and each of the children paid her out of their personal funds their one-third of the losses sustained. The net loss to each was $93,634.42.

An accurate statement of the market value of the assets of the Hudson Finance Co. at the time the notes and stock were transferred to Clifford D. Beebe can not be obtained, but it was the opinion of the Smiths at that time that the assets would not have sold for sufficient to pay the corporation's liabilities. The assets of this corporation on March 1, 1913, appear to have been largely in excess of its liabilities. The losses which accrued, therefore, accrued after March 1, 1913.

The revenue agent disallowed these losses to the individuals on the ground that they were contingent liabilities against the estate of Lyman C. Smith, and held that they agreed to assume these liabilities merely as a matter of convenience to themselves, and that if they had not done so they would have received this much less from the estate of their father, Lyman C. Smith. This conclusion, however, overlooks the fact that at the death of Lyman C. Smith the assets of the Hudson Finance Co. were more than sufficient to pay off these notes.

The liability of Lyman C. Smith's estate on the notes of the Hudson Finance Co. was that of accommodation indorser. When the banks which held the notes accepted Burnes Lyman Smith as indorser instead of his father, they by that act released the estate of Lyman C. Smith from all further liability. The debt was from that time the debt of the Hudson Finance Co., Burnes Lyman Smith, et al., indorsers, although Burnes Lyman Smith was protected as to two-thirds of his liability by the agreement with his mother and sister to share equally with him any losses he might sustain. When the notes became due Mrs. Flora Burnes Smith took them up and held them as a liability against the corporation and the indorsers, two of whom had become insolvent. Mrs. Flora Burnes Smith, however, was protected by Burnes Lyman Smith's indorsement and by the agreement of Flora Bernice Smith to share one-third of the losses. The agreement with Burnes Lyman Smith, to the effect that he would share the losses with his mother and sister, was a release by his mother of his liability as an indorser to her except as to one-third of any losses she might sustain.

In view of the foregoing it is held that Burnes Lyman Smith, Mrs. Flora Burnes Smith, and Miss Flora Bernice Smith each suffered a loss of one-third of the total loss sustained in this transaction and that such losses are deductible under section 214 of the revenue act of 1918 in computing their respective net incomes for 1919.

CARL A. MAPES,
Solicitor of Internal Revenue.

GENERAL REPORT ON SPECIAL ASSESSMENT

[By L. H. Parker, Aug. 13, 1925]

AUGUST 13, 1925.

To: Mr. L. C. Manson, general counsel.
From: Mr. L. H. Parker, chief engineer.
Subject: Special assessment.

SYNOPSIS

From an examination of the methods employed in general and from a study of individual cases, it appears—

1. That the application of section 210 of the act of 1917 is sound where the invested capital of the taxpayer could not be satisfactorily determined.

2. That the bureau has exceeded its authority in making retroactive the provisions of section 327 and 328 of the 1918 act in regard to abnormalities in invested capital and income to apply to the year 1917.

3. That the whole method of special assessment granted to companies under section 327 of the act of 1918 on the basis of abnormalities in invested capital and income is unsound.

4. That the administration of these sections by the bureau has caused "a frightful discrimination between business concerns and industries of the country."

BUREAU'S METHOD OF DETERMINING SPECIAL ASSESSMENT

Special assessment was first provided for in a revenue act of 1917. This act states as follows in section 210:

"SEC. 210. That if the Secretary of the Treasury is unable in any case satisfactorily to determine the invested capital, the amount of the deduction shall be the sum of (1) an amount equal to the same proportion of the net income of the trade or business received during the taxable year as the proportion which the average deduction (determined in the same manner as provided in section 203, without including the $3,000 or $6,000 therein referred to) for the same calendar year of representative corporations, partnerships, and individuals, engaged in a like or similar trade or business, bears to the total net income of the trade or business received by such corporations, partnerships, and individuals, plus (2) in the case of a domestic corporation $3,000, and in the case of a domestic partnership or a citizen or resident of the United States $6,000."

"For the purpose of this section the proportion between the deduction and the net income in each trade or business shall be determined by the Commissioner of Internal Revenue in accordance with regulations prescribed by him, with the approval of the Secretary of the Treasury. In the case of a corporation or partnership which has fixed its own fiscal year, the proportion determined for the calendar year ending during such fiscal year shall be used."

It will be noted that the wording of the act provides for special assessment only in the cases where the invested capital of the taxpayer can not be satisfactorily determined. There is absolutely no reference in the 1917 act to abnormalities in invested capital and income which might permit a relief under this section. This feature of taking account of abnormal conditions in the invested capital or income of the taxpayer was first introduced by the revenue act of 1918 which allows a taxpayer to be assessed under this section, "owing to abnormal conditions affecting the capital or income of the corporation," an exceptional hardship would be borne by the taxpayer if his tax was computed without benefit of the special assessment provisions. The act of 1921 was practically the same as the act of 1918. The act of 1924 does not contain a special assessment provision inasmuch as it is no longer necessary to compute the invested capital of the taxpayer.

There is nothing in the acts of 1918 or 1921 making the wording thereof in respect to abnormal conditions retroactive. However, the bureau has consistently at least in later years, given relief to taxpayers under section 210 of the 1917 act on account of abnormal conditions, a feature which was not included in this act at all. This is conclusively shown, for instance in appeals and review recommendation No. 326, which can be found in Cumulative Bulletin No. 3, page 361. This ruling provides as follows:

"If a corporation has paid no salaries to its officers during 1917, or has paid salaries which were unusually low in comparison to the salaries paid to the officers of competing concerns, and thereby created an abnormal condition which seriously affected its net income and tax liability, it may properly receive consideration with a view to determining its excess profits tax liability for 1917 in accordance with section 210 of the revenue act of 1917."

The bureau has exceeded its authority in making the provisions of the 1918 act, in regard to special assessment retrospective in regards to fixing the 1917 tax. Another case of this kind has already been shown in the report upon the J. H. Hillman Co. case where they were allowed special assessment for the year 1917 based on abnormal conditions although their invested capital could satisfactorily be determined.

We will now state the general method employed by the bureau in determining special assessment cases, which as we have shown above have been computed under the same principles for 1917 as for 1918 and 1921 regardless of the fact that the wording of the acts are different.

The first step in a special assessment case is to determine whether or not the taxpayer is entitled to relief under the section. Some of the reasons for granting special assessment are listed below.

1. Insufficient salaries paid to officers.
2. Sale of capital assets within the taxable year.
3. Substantial intangible value in a business of small capitalization.
4. A corporation operating with a large amount of borrowed capital.
5. Where respective values of mixed aggregates of tangible and intangible properties paid in for stocks and bonds can not be satisfactorily determined.
6. Foreign corporations.

After it has once been determined that the taxpayer is entitled to special assessment, the tax is always computed in its entirety without any reference to how much difference the abnormality could possibly make in the tax.

As a rule five companies are selected which are in the same line of business as the taxpayer and if possible these companies are selected as also being in the same location and about the same size as the appellant company. The five companies selected are termed comparatives. Complete information as shown on returns is tabulated on a work sheet for each of these five companies, and also for the appellant company. The most important parts of this information is as follows:

1. Invested capital.
2. Gross sales.
3. Cost of goods sold.
4. Net income.
5. Percentage of net income to gross sales.
6. Percentage of net income to invested capital.
7. Percentage of cost of sales to gross sales.
8. Profits tax.
9. Percentage of profits tax to net income.
10. Average of percentage of profits tax to net income for the five comparatives.

The final determination of tax under special assessment is based on the average of the percentage of profits tax to net income for the five comparatives chosen. This average percentage is applied to the net income of the appellant company to determine the profits tax and the normal income tax of 12 or 10 per cent, as the case may be, added to this profits tax to obtain the total tax.

The other information is used and tabulated in order to see that the comparatives chosen bear the proper similarity to the business of the appellant company.

DISCUSSION OF BUREAU'S METHOD

We believe that the provision for special assessment as contained in the 1917 act, section 210, is sound and is necessary when the invested capital of the taxpayer can not be satisfactorily determined.

We disagree entirely with the policy of the bureau in making the new principles involved in the 1918 act retroactive to 1917 when there was absolutely no authority therefor.

The 1918 act provides for determining the tax by special assessment in the following four classes:

(*a*) Where the invested capital can not be determined.

(*b*) In the case of foreign corporations.

(*c*) Where a mixed aggregate of tangible property has been paid in for stock and the values of the several classes of property can not be satisfactorily determined as at time of payment.

(*d*) Where "the tax if determined without benefit of this section would, owing to abnormal conditions affecting the capital or income of the corporation, work upon the corporation an exceptional hardship evidenced by gross disproportion between the tax computed without benefit of this section and the tax computed by reference to the representative corporations specified in section 328 this subdivision shall not apply to any case (1) in which the tax (computed without benefit of this section) is high merely because the corporation earned within the taxable year a high rate of profit upon a normal invested capital nor (2) in which 50 per cent or more of the gross income * * * consists of gains, profits, commissions or other income, derived on a cost plus basis from a Government contract. (Made during war period.)

In regard to the first three provisions above, (*a*), (*b*), and (*c*), we believe these are sound and when special assessment is granted on these grounds we can make no criticism.

When special assessment is granted under provision (*d*), however, we are not at all in agreement with the way this section has been interpreted by the bureau.

In order to discuss this matter intelligently, it will be necessary to cite certain grounds upon which the bureau has allowed special assessment. One of the most often recited reasons for granting special assessment is on the plea, that the taxpayer paid insufficient salaries to its officers. We will therefore attempt to analyze this particular ground for special assessment.

A careful reading of paragraph (d) of section 327 of the 1918 act, will convince one that an "exceptional hardship" must be worked on the corporation by the computation of the tax in the ordinary way. While this hardship may be evidenced by "gross disproportion" between the statutory tax and the tax computed by the special assessment method, this gross disproportion alone is not a sufficient ground for such assessment. It must be kept clearly in mind that one of the basic principles of the act is the fixing of the tax according to the taxpayer's ability to pay, and while any tax may be a hardship, it can be construed only as an exceptional hardship, in view of the general principles governing the whole revenue act, when the taxpayer would be so affected that he is seriously prejudiced in maintaining his business and competing with his rivals in the same industry, or when it comes to the point where he is really unable to pay.

Let us examine now the "exceptional hardship," borne by the taxpayer corporation because it pays too small salaries to its officers.

In the J. H. Hillman Co.'s case, the three executives of the company drew salaries of $12,000 each, or a total of $36,000. It was claimed that they should have been paid at least $50,000 each plus 10 per cent of the net earnings, or a total of $500,000. The company then claims to have paid $464,000 less in salaries to its officers than it should have done. This is claimed to be an "exceptional hardship" to the corporation.

Let us see what this hardship amounts to. The company should have paid its officers $464,000 more in salaries. This saves the corporation $464,000 in expense. The company had to pay tax on this $464,000 which could not be deducted from income. With a composite profit-tax rate of 55 per cent plus the regular income tax, this loss would amount to about $283,040. Then the corporation stands as follows at the end of the year:

Saved on officers salaries	$464, 000
Loss due to additional tax	283, 040
Net saving	180, 960

In other words the corporation claims it has suffered an "exceptional hardship" because it has saved $180,960 net cash. The remarkable part of it is, that the bureau agrees with the taxpayer.

While the wording of the act definitely states that it must be a hardship on the corporation, it is interesting to note the hardship which might be borne by the three principal officers of this company, the small stockholder and the Government on account of this payment of insufficient salaries.

In this case the three principal officers were the three principal stockholders, not knowing the exact facts, we will assume they hold 90 per cent of the stock, and that the income derived from the corporation is their only income.

Now, each of these officers lost by not receiving the salary claimed proper, the amount of $154,667, or a total of $464,000 for the three officers. They had a total additional equity in the business, however, of 90 per cent of $180,960, which equals $162,864. They have also saved the tax on the additional salary which would amount to $37,019 each, or a total of $111,057.

Then the hardship on the three principal officers is as follows:

Loss due to insufficient salary		$464, 000
Additional equity in business	$162, 864	
Saving on tax	111, 057	
		273, 921
Net loss (three officers)		192, 079
Or each officer lost		63, 356

Now, it is evident that this could be considered a hardship on the three principal officers, yet we maintain that it is not an exceptional hardship, as each of the officers is certainly assured of the necessities of life through their $12,000 per year salary. Moreover, section 327 of the act certainly clearly refers only to exceptional hardships borne by the corporation, and had nothing to do with the relief of individuals. Furthermore, the three principal officers owning 90 per cent of the stock had it in their power to vote themselves a proper salary; it is therefore a matter about which the Government should not concern itself.

In regard to the small stockholders, the "hardship" borne by them because the company paid its officers insufficient salaries amounts to an additional equity for them in undivided profits of 10 per cent of $180,960, or $18,096. In other words, the small taxpayers have gained $18,090 instead of suffering a hardship because the company paid its officers insufficient salaries.

In regard to the Government, it is evident from the above that on account of the corporation having paid its officers too little salary they have collected—

A tax on the company (gain)	$283, 040
A tax on the officers (loss)	111, 057
Net gain	171, 983

The results of the above discussion show that the result of paying small salaries is as follows:

Saving to corporation	$180, 960
Saving to small stockholders	18, 096
Saving to Government	171, 983
Loss to three principal officers	190, 079

From the above it must be evident that the only hardship is to the three principal officers, and as the act clearly intends relief only to the corporation this ground for special assessment should be condemned.

Another ground for special assessment is the sale of capital assets by the corporation within the taxable year.

The general intent of the whole act with the exception of special assessment section as construed by the bureau, was to tax as income the appreciation of all capital assets between March 1, 1913, and the date of sale at the tax rates obtaining when the sale was made.

We see no reason for interpreting the meaning of section 327 on special assessment in such a manner as to make the provisions of act for determining profit on sale of capital assets null and void.

If a corporation sells part or all of its assets it is usually because it does not require them further, and this feature has nothing to do with the profit on the articles they produce. It is true that the realization of profits in a year of high taxes bring about a tax which is a hardship, but it is a condition recognized by the law as operating on every individual and corporation and we do not believe it was the intent of Congress to provide in this section for making the other section of the act inoperative.

Article 541 of the regulations for 1918 define gross income as follows:

"The gross income of a corporation for the purposes of the tax in general includes and excludes the same things as the gross income of an individual. It embraces not only the operating revenues, but also gains, profits, and income from all other sources, such as rentals, royalties, interest, dividends from stock of other corporations, and profits from the sale of capital assets."

It is definitely recognized, therefore, that the profits from the sale of capital assets are a part of the taxable income of a corporation. Why then should certain corporations be relieved of the tax on same? We can not agree with the bureau in admitting cases to special assessment on the ground of excessive income due to sale of capital assets when the act specifically provides for taxing the profits from such sale.

This ground for special assessment has been granted in a number of cases, among which might be mentioned "The Morton-Gregson Co., Chicago, Ill."

Another ground on which special assessment is granted is where there is substantial intangible value in a business of small capitalization. There is equity in certain cases on this ground, and we believe that Congress may have intended to relieve such cases.

For instance, we will suppose two companies are doing business in the same industry. These companies are exactly the same and make the same income, but one incorporated at $400,000 par value of stock and the other at $700,000 par value of stock, $300,000 thereof being issued for good will. Now, it is evident that the first company only has an invested capital of $400,000, while the second company can get $400,000 plus 25 per cent of $700,000, or $575,000. Therefore, the first company must pay a much higher rate than the second simply because it did not take good will into account in incorporating. We do contend, however, that when special assessment is granted on this ground, that the constructed invested capital should not be increased beyond the 25 per cent limit provided for in section 326 of the 1918 act. All companies have to bear this limitation and it is unfair to give more relief under section 327 than the ordinary taxpayer gets under the regular case in section 326.

It is conceded also that borrowed capital may constitute a proper ground for extra assessment. There seems to be ample evidence that this was the principal matter in the minds of Congress when writing this provision of the law. We do contend, however, that due allowance should be made for the extent of the abnormality due to this cause and also for the deduction of interest on this borrowed capital. If the extent of the abnormal condition is taken into account, then allowances will become within reason.

There is of course no question as to the use of special assessment in the case of foreign corporations or where respective values of mixed aggregates of tangible and intangible properties paid in for stocks and bonds can not be satisfactorily determined, as these features are specifically covered by the act.

There are several other grounds for granting special assessment, one of which is based on the extraordinary value of the personal services rendered by the officers of the company. This ground is too ridiculous to argue, for it is evident that efficient management of a corporation should not be considered an abnormal condition or one demanding relief from taxation.

Individual Cases

In order to make the special assessment methods of the bureau clearer, we will now give a résumé of certain cases, or groups of cases, the full details of which will be attached as exhibits:

J. H. HILLMAN & CO., PITTSBURGH, PA.

The principal reason for granting special assessment in this case was the extraordinary personal business genius of Mr. J. H. Hillman, jr., and two other officers of the company. Other reasons advanced were the small salaries paid these officers, the good will not possible of capitalization, the small amount of capital required in the coal-brokerage business, and realization of profits in 1917 representing earnings upon services performed during preceding years.

While the grounds of special assessment in this case are all weak, we will not discuss them. The main point is that special assessment could not properly be granted this company at all under the 1917 act, because the invested capital of this company could be satisfactorily determined, and the bureau has made retroactive the provisions of the 1918 act without any authority. The facts in this case are included in Exhibit A attached, the following conclusions being reached therein:

1. There were no proper grounds for granting this taxpayer relief by special assessment in 1917.
2. Only two comparatives were used in determining the ratio of profit tax to net income, instead of the usual five comparatives.
3. Five comparatives were available and in fact set up on a work sheet; the two used had the lowest rates and hence were most advantageous to the taxpayer.
4. The comparatives discarded were thrown out on the basis of being smaller-sized companies. In other words, small companies should, according to the bureau, pay more tax than large companies.

GROVES MILLS (INC.), GASTONIA, N. C.

This case is interesting as it shows the elasticity of determinations made under special assessment.

First determination:

1917. Taxpayer assessed 38.68 per cent of net income as profits tax.
1918. Taxpayer denied special assessment, statutory rate of 61.34 per cent of net income assessed for profits tax.

Second determination:

1917. Taxpayer assessed 33.71 per cent of net income as profits tax.
1918. Taxpayer assessed 47.10 per cent of net income as profits tax.

Third determination (as result of special investigation):

1917. Taxpayer denied special assessment and assessed at the statutory rate of 41.7 per cent of net income as profits tax.
1918. Taxpayer assessed 57.7 per cent of net income as profits tax.

From the above determinations it is readily seen how elastic the results of special assessment can be made. For the year 1917 we have successive determinations of profits tax at rates of 38.7 per cent, 33.7 per cent, and 41.7 per cent; while for 1918 we have rates of 61.34 per cent, 47.10 per cent, and 57.7 per cent.

We append under Exhibit B attached, a copy of data or work sheet used for the final determination of the profits tax in this case for the year 1918. We believe that a study of this sheet would convince any one that this company is not entitled to special assessment at all, inasmuch as no exceptional hardship is shown. It is interesting to note that this company pays it's officers salaries three times greater than any other comparative company. Inasmuch as the bureau has determined that a company which pays insufficient officer's salaries is entitled to special assessment, would it not be reasonable to deny companies special assessment when such companies pay their officers excessive salaries? A study of the invested capital and the net incomes shown on the data sheet reveal very little abnormality in the appellant company.

We quote as follows from the recommendations from the special assessment section for this company, covering the year 1918:

"From the data sheet prepared it appears that the salaries paid to the officers were in excess of the salaries paid by representative concerns. However, it is not known whether the excess was sufficient to cover the abnormality claimed by the appellant and inasmuch as there appears to be a slight abnormality in the income and invested capital for this year, it is recommended that special assessment be allowed in accordance with the new data sheet prepared."

There is nothing in the above recommendation showing sufficient grounds for special assessment inasmuch as no exceptional hardship is shown. The recommendation itself admits only a slight abnormality. It must be admitted that practically every taxpayer in the country has slight abnormalities in its income, or in its invested capital, and that if we are to admit any such grounds as the above, we must admit practically every corporation in the country to treatment under this special provision of the act. We contend that no such intention was in the minds of Congress when they included this provision, nor in fact can the wording of the provision itself be construed to cover this case.

ADAMS WOOLEN MILLS, ADAMS, MASS.

Grounds for special assessment in this case which were granted by the unit are as follows:

1. That the capital stock was not issued for the full value of the assets taken at the time of reorganization.

2. At the time of reorganization receiver's compensation, attorney's fees, taxes, interest, and miscellaneous expenses amounting to approximately $7,543.60 were treated as such on the books.

3. Low officers' salaries.

We contend that none of the above grounds are proper grounds for allowing this case special assessment, inasmuch as regular provisions of the act contain methods by which proper relief can be afforded under much more scientific and equitable methods.

For instance, it is claimed that the capital stock was not issued for the full value of assets taken in at the time of reorganization. Section 326 of the revenue act of 1918 provides as follows in regard to what can be included in invested capital:

"Actual cash value of tangible property, other than cash, bona fide paid in for stock or shares, at the time of such payment, but in no cases to exceed the par value of the original stock or shares specifically issued therefor, 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."

It is obvious that if at the time of reorganization the company knew that the par value of stock was not equal to the value of its assets, it must have known the value of these assets as carried on the predecessor company's books. Therefore, a basis for the true value of this property could be established by this means. Failing in this method, then, an inventory of the assets as of date of reorganization properly valued by means of a retrospective appraisal should furnish additional evidence. If 50 per cent or more of the stock of the new company remained in the control of the previous owner, which would throw out the right to a retrospective appraisal at the date of reorganization, then the invested capital of the predecessor corporation could still have been determined by reconstruction of accounts. We see no reason for admitting this company for special assessment on these grounds until the methods outlined above were investigated.

We wish to point out at this point that while the unit in selecting comparatives has attempted to choose comparatives of the same size and of the same location, they have utterly disregarded the very important feature of date of organization. It is quite obvious from a study of the regular provisions of the act that if we have two companies which have exactly the same plant and exactly the same output and profit, but one of the companies is incorporated in 1903 and the other in 1916, then it was the intention of Congress not to tax these companies alike. In the first place, the company incorporated in 1903 would probably have paid $200,000 for its plant, while the company incorporated in 1916 would have had to pay about $300,000 for a plant for the same capacity. Furthermore, through depreciation allowances, the company incorporated in 1903 would have had returned to it a large portion of its capital invested. It is obvious then that the old company will have less invested capital in 1918 than the new company and will pay a higher rate of tax. As we understand the construction of the whole act, this was the intent of Congress. If now we admit to special assessment a certain old company and compare it with companies organized 10 or 15 years subsequently, it can be seen that we are giving this company too favorable treatment and that we are committing an injustice against the old companies which are not admitted to special assessment.

The second grounds for special assessment are ridiculous. The exact amount of charges which should have been made to capital account instead of to expense are known and the invested capital of the taxpayer could have been adjusted without any reference to the special assessment provision.

The third reason given for special assessment is based on insufficient salary to officers. We have already discussed this matter and we believe we have shown conclusively that low officer's salaries do not constitute an exceptional hardship to a corporation, but on the contrary are an advantage thereto.

In order to show clearly the wide limits within which the profits tax of a taxpayer can be determined by the special assessment method used by the bureau, we append herewith under Exhibit "C," a work sheet showing the bureau's determination as actually found by the use of six comparatives, and also substitute determination numbers 1 and 2, which your engineers have computed by the substitution of certain other comparatives selected from the records of the Special Assessment Section to be used for this purpose.

It will be noted from this chart that the statutory profits tax of the Adams Woolen Co. was $86,757; that the bureau's determination of this profits tax by special assessment is $66,269, while our substitute determination No. 1 shows a profits tax of $76,717, and substitute determination No. 2 shows $56,589. This shows the very wide latitude possible in determinations under this method. In the same way, while the actual invested capital of the taxpayer is $177,159, the bureau's determination would reconstruct this at $543,002, while our determination No. 1 would show the constructed invested capital to be $356,439 and determination No. 2 would give $715,867.

It is our contention that where a special assessment must be used, then the taxpayer should be compared with representative firms who are operating efficiently, and that the dates of organization of the comparative companies should agree approximately with the date of organization of the appellant company. Any other system will create an injustice against those companies who are not admitted to special assessment but who realize large profits on their invested capital.

TAFT WOOLEN CO., CARYVILLE, MASS.

The determination of special assessments for this company again shows the elasticity of the bureau's method as in the case of the Goves Mills Co. The statutory rate of profits tax to net income in this case was 72.25 per cent. The case was closed under Section 327 and 328 by allowing a rate of 55.05 per cent. Upon later investigation the bureau reopened this case and determined the profits tax at 64.30 per cent of the net income. The statutory profits tax would have amount to approximately $414,000, while the first determination reduced this to $310,000, and the final determination arrived at a tax of $362,000. The variation in these figures is obvious and requires no discussion.

The grounds for special assessment in this case were three in number, as follows:

"1. Due to ultraconservative accounting the statutory invested capital can not be satisfactorily determined.

"2. A large portion of the net income is derived from the use of borrowed capital.

"3. The net income is principally derived from the valuable trade-marks and good will which can not be recognized in computing statutory invested capital."

In regard to the first ground given above, we contend that this is not a sufficient reason for special assessment inasmuch as items improperly charged to expense can be readily capitalized and the capital account reconstructed.

The second ground for special assessment in regard to borrowed capital has some foundation. However, no attempt is made by the bureau to determine the extent to which this abnormality, if any, could possibly effect the tax of this company. It is a normal rather than an abnormal condition for companies to borrow a certain amount of money in conducting their business. The interest paid by this company would indicate that if they borrowed money at 6 per cent, the amount of capital borrowed would be about 40 per cent of their invested capital. It is not by any means unusual for companies to borrow from banks up to 50 per cent of their net assets. We will discuss the borrowed capital feature of special assessment later.

In regard to the third grounds for special assessment, relating to the value of trade-marks and good will, it is certain that if this ground is admitted at all it ought to be confined to the 25 per cent limitation placed on valuation of good will for all companies under the regular provisions of the act.

PENN TOBACCO CO., WILKES-BARRE, PA.

This company is a manufacturer of tobacco and has been granted special assessment for the years 1917 and 1918. We shall discuss here only the allowance for special assessment in 1917. Invested capital of the taxpayer amounted to $474,789, the gross sales amounted to $1,213,802, his net income amounted to $121,826.11, his statutory profits tax amounted to $20,749, the percentage of profits tax to net income was 17.03 per cent. Under special assessment the profits tax was reduced to $19,345.99, the percentage of profits tax to net income being fixed at 15.88 per cent.

The grounds for special assessment in this case were based on the proposition that the taxpayer had created large good-will values through advertising which were not included in invested capital. The taxpayer claimed that he had spent in the neighborhood of $900,000 between 1900 and 1912 for advertising; he claimed all this should go into invested capital. We do not think that this ground was well taken, because advertising in general has to be kept up from year to year and it is very questionable what effect advertising between the years 1900 and 1912 would have on the real value of the intangibles of this taxpayer in 1917. Furthermore, it was the custom of the taxpayer to charge advertising to expense. If he charged off in 1917 a very considerable amount of advertising as expense instead of capitalizing same, this would more than offset the amount by which the invested capital would affect the tax. However, we have not the true facts in regard to this.

In any event, we claim that this taxpayer should not have been granted special assessment for the year 1917, inasmuch as his invested capital could be determined; and, as we have already pointed out, companies should only be granted special assessment under section 210 when their invested capital can not be satisfactorily determined.

WEYMAN BRUTON CO., NEW YORK, N. Y.

This company is a manufacturer of tobacco. It was granted special assessment for the year 1917. The invested capital of this taxpayer amounted to $9,098,583, his gross sales amounted to $7,576,033, his net income amounted to $1,881,642, his statutory profits tax amounted to $243,989, the percentage of statutory profits tax to net income amounted to 13 per cent. Under special assessment the taxpayer's profits tax was fixed at $159,375 and the percentage of profits tax to net income was fixed at 8.47 per cent.

This company was granted special assessment on the grounds that invested capital could not be satisfactorily determined. Just why it could not be so determined is not evident from these records in our possession. It would appear rather strange that the invested capital could not be determined when the invested capital of the taxpayer before reconstruction is given at $9,098,583, as shown above.

We wish to draw special attention in this case to the very low rate of profits tax finally determined, i. e., 8.47 per cent. The statutory rate of 13 per cent which would have been assessed this taxpayer if he had not been granted special assessment would appear to be a very reasonable rate of taxation for the war year 1917. It will be noted, however, that the relief afforded this taxpayer is considerable as it effects the reduction of over one-third in his profits tax, or an amount of $84,614.

COMPARISON OF THE WEYMAN BRUTON AND PENN TOBACCO CO. CASES

We wish to make a nontechnical comparison of the two cases listed above in view of the results of special assessment. These companies are both tobacco manufacturers, though the details of their business are somewhat different. We wonder what will be the reaction on the Penn Tobacco Co. when they find out that although they made a profit of only $121,000, they had to pay a profits tax of 15.88 per cent thereon, while the Weyman Bruton Co., making a large profit of $1,881,642, only had to pay 8.47 per cent profits tax thereon.

We contend that the whole principle lying behind the excess profits tax as laid down by Congress in the revenue act of 1918 is violated by the application of special assessment to this case. It must be admitted that one of the basic principles of this tax was on the taxpayer's ability to pay. Certainly a company making nearly $2,000,000 could afford to pay over 8 per cent profits tax without suffering any exceptional hardship. We have noted in general, in the limited time spent in the special assessment section, that small companies in a given industry are assessed a higher percentage of tax than large companies in the same industry when treated under the special assessment provisions of the act as carried out by the bureau's methods. We believe if the public at large knew how this provision was being interpreted and what refunds were being handed out they would not for one moment stand for such injustice.

LOUISVILLE PROVISION CO., LOUISVILLE, KY.

This company applied for special assessment for the years 1917 and 1918. The company was denied relief under this section of the act on the grounds that companies in comparative circumstances paid a higher rate of tax than the appellant. The ratio of profits tax to net income for the appellant company for 1917 was 8.93 per cent, while the same ratio for comparative companies was fixed at 17.94 per cent. For 1918, the appellant company was assessed a profits tax of 32.22 per cent of its net income, while the comparatives selected by the bureau showed a ratio of the profits tax to net income of 40.72 per cent. The gross sales of this company in 1917 amount to $2,299,083.

We believe the bureau was correct in denying this company special assessment, but we have quoted the above figures for comparative purposes. The business of the above named taxpayer was that of a meat packer and dealer in provisions.

MORTON-GREGSON CO., CHICAGO, ILL.

This company was granted special assessment for the year 1917 on the ground that part of its income was derived from the sale of capital assets.

As before stated, we condemn this ground for special assessment especially for the year 1917. The only grounds for granting special assessment in this year is when the invested capital of a taxpayer can not be satisfcatorily determined. Income derived from sale of capital assets has nothing whatever to do in the determination of invested capital.

The gross income of this taxpayer was $4,396,070, his net income was $288,057, his statutory profits tax was $52,714, the percentage of profits tax to net income was 18.30 per cent. The bureau has determined the profits tax of this taxpayer by their special assessment method at $28,177.99, and the per cent of profits tax to net income at 9.78 per cent. In other words, the bureau has cut this taxpayer's tax nearly in half.

It should be noted that in the preceding case of the Louisville Provision Co. for the year 1917 the average percentage of profits tax to net income of the comparatives was found to be 17.94 per cent. The bureau seemed to have no great difficulty in this case of the Morton-Gregson Co. to find comparatives which would indicate a proper profits tax at the very low figure of 9.78 per cent. Only three comparatives were used in this Morton-Gregson case, although an ample number were available. It appears evident that this taxpayer has received preferential treatment.

KINGAN & CO. (LTD.), INDIANAPOLIS, IND.

This company has been allowed special assessment for the year 1918, on the basis of being a foreign corporation. There is no question but what this ground for special assessment is proper.

The gross sales of this company amount to $63,559,919, and the per cent of profits tax to net income is fixed at 29.05 per cent. In arriving at this percentage only two comparatives are used, one paying a profits tax of 36.20 per cent and one a profits tax of 14.94 per cent. We do not think that these two comparatives are sufficient to fix the proper rate, especially in view of the wide divergence between the two rates shown in the comparatives. Attention might be called again to the case of the Louisville Provision Co., quoted previously, which shows an average rate of profits tax to net income for 1918, in this line of business, to be 40.72 per cent. It is true that these comparatives are much smaller companies, but can we admit of the principle that small companies should pay a greater relative profits tax than large companies.

Under Exhibit D attached, a résumé of the special assessment determination in this case is shown. We have also computed in this exhibit the rate of profits tax to net income for this company by changing one of the comparatives. By so doing, we would change the rate of profits tax to net income from 29.05 per cent to 36.8 per cent. This would make a difference in tax in favor of the Government in the sum of $210,000.

HATELY BROS. CO., CHICAGO, ILL.

This company is in the packing business as in the case of Kingan & Co. They have been admitted to special assessment for 1918 on the basis of borrowed capital, low officer's salaries, and good will value not included in invested capital. The ratio of profits tax to net income in this case is fixed at 42.79 per cent, it will be recalled that the rate for Kingan & Co. was fixed for this same year at 29.05 per cent. It is true that Kingan & Co. is a much larger concern, but we must conclude from the results of the bureau's methods that a large foreign meat packer should pay 13 per cent less profits tax than a small American meat packer. We do not believe the American public will like this system.

The idea has been so often expressed that the special assessment provision was necessary to allow one company to compete with another, that we wish to take up this phase of the matter in connection with this case. For convenience we will take the figures for the appellant company and one of the comparatives used by the bureau in this case in order to illustrate this point.

	Hately Bros. Co.	Comparative		Hately Bros. Co.	Comparative
Location	Illinois.	Illinois.	Interest	$.2,821	$4,072
Invested capital	$502,421	$490,928	Taxes	3,318	50
Gross sales	4,760,030	4,546,544	Bad debts	1,967	7,728
Other income	10.,483	9,968	Depreciation	11,760	15,287
Cost of goods sold	4,560,321	4,230,973	Net income	171,408	110,750
Ordinary and necessary expense	54,514	156,008	Profits tax	89,917	39,820
Compensation officers	16,666	30,000	Per cent profits tax to net income	52.45	35.95
Repairs	2,734	9			

Final profits tax allowed Hately Bros. by special assessment, $73,354.
Final percentage of profits tax to net income allowed, 42.79.

From the above it can be seen that these two companies are quite similar, but that Hately Bros. make more money than the other concern. Let us examine the figures to see how it is that Hately Bros. can not properly compete with the other company and therefore require special assessment. The fact that will affect the competition of these companies most is the amount of money each has left at the end of the year for expansion and carrying on their next year's business. It can be seen that the companies are very nearly the same in invested capital and gross sales.

Now, if Hately Bros. had paid the statutory tax, they would have had left at the end of the year their net income less the tax for which they were liable; this would amount to $171,408, less tax $89,917; balance, $81,491. The other company would have left $110,750, less $39,820; balance, $70,930.

Can it be said that Hately Bros. can not compete with the comparative company because they have left a net profit of $81,491 instead of only having left the net profit of $70,930, made by the other company? We think this argument is entirely fallacious when we remember that the companies are of practically the same size. However, the bureau adjusts the tax of Hately Bros. so that they really have left $171,408 minus $73,354, or a balance of $98,054.

We now have Hately Bros. with $27,000 more on hand at the end of the year than the comparative company, and what is really accomplished by this method is not a relief in taxation which will permit Hately Bros. to compete with the comparative concern, but we have created a condition by which the comparative company can not now compete on equal terms with Hately Bros.

UNITED VERDE EXTENSION MINING CO., NEW YORK, N. Y.

The business of this taxpayer is copper mining, milling, and smelting. This case has been discussed in our office report No. 28, in regard to this company. It has certain special assessment features which are important to take up at this time, one of which is to show how millions in tax can be lost to the Government by this method.

The tax on this company was originally fixed by the advisory tax board under section 210 of the 1917 act (special assessment). It amounted to $2,123,809.55. The details of this assessment can not be found which show the comparatives used. Through methods which we have questioned in office report No. 28, above referred to, this tax was the one finally allowed to stand. However, we have a computation of tax on this same basis made subsequently which shows a tax of $2,845,070.37, as this is $700,000 more than the tax collected, this determination will do for our purpose although it is in favor of the taxpayer. Under this determination the rate of profits tax to net income was fixed at 21.29 per cent.

The net income of the taxpayer was $10,937,277. The profits tax on a statutory basis would have been, according to our report, $5,739,100, or a ratio of 52 per cent to net income. The taxpayer, therefore, has saved $3,410,554 in profits tax by this determination of special assessment over what he would have paid on a statutory basis. The above figures are based on a tax shown by the comparatives that we have available, actually of course, the taxpayer saved about $700,000 or more. It is claimed that the taxpayer could not determine his invested capital. We question this statement inasmuch as the statutory tax was actually computed as shown above.

We are quoting as follows from our office report No. 28, covering the United Verde Extension Mining Co.:

Representative rate.—In arriving at a representative rate, five companies were selected, as follows:

	Invested capital	Net income	Per cent net income to invested capital	Excess-profits tax	Per cent tax to net income
Arizona Copper Co.	$35,140,023	$8,181,847	23.28	$1,383,651	16.91
Mammoth Copper Co.	948,428	420,771	44.37	141,845	33.71
Shattuck-Arizona Copper Co.	3,141,310	1,617,197	51.48	592,761	36.65
Chino Copper Co.	20,324,105	10,880,261	53.53	4,062,187	37.34
Calumet & Arizona Co.	41,045,372	8,307,313	20.24	1,026,389	12.36
Total	100,599,238	29,407,389		7,206,833	
Average	20,119,848	5,881,478	29.25	1,441,367	21.29

From the average per cent of net income to invested capital, 29.23 per cent applied to the corrected net income, $10,937,277.99, is obtained a constructive invested capital of $38,986,896.54. This constructive invested capital then becomes the basis for the excess-profits tax computation as provided in the regulations.

The excess-profits tax thus computed amounts to	$2,328,546.48
Tax at 2 per cent	172,174.63
Tax at 4 per cent	344,349.26
Total tax	2,845,070.37

In addition to drawing attention to the fact that this taxpayer has been saved $3,000,000 by special assessment, we also wish to point out the injustice suffered by the Mammoth Copper Co., the Shattuck-Arizona Copper Co., and the Chino Copper Co. These companies pay a profits' tax on their net income based on the following percentages, respectively, 33.71, 36.65, and 37.34 per cent. The appellant company only has a rate of 21.20 per cent. Is it fair for the Chino Copper Co. to be assessed $4,000,000 on a $10,000,000 income and still let out the United Verde Extension Mining Co. with a tax of only a little over $2,000,000 on practically the same net income, just because it claims its invested capital could not be determined? We believe that it was the intention of Congress, in such cases, to bring the tax down to a point where it would equal the average of certain companies which were making a maximum return in that industry rather than on any general average.

While it is aside from this subject, we wish to call attention to the fact that the above-quoted figures show that these copper companies are making a profit of 29.23 per cent on their invested capital. In view of the many arguments the bureau tries to advance in regard to proper rates which a copper company would expect to make in its business, which they variously state from 7 to 10 per cent, would it not be well for their experts to wake up to the fact that the copper companies were really making 29 per cent, and that other investors would certainly expect to make in this industry a profit which was shown reasonable by past experience?

Another point of interest in this case of the United Verde Extension Mining Co. is the failure of the bureau to select as a comparative the United Verde Mining Co. This latter company is in the same locality and in the same kind of ore as the appellant company. By omitting this company the bureau has committed an injustice to the United Verde Co. which pays a much higher rate of tax than the appellant. If there was any company which should have been properly selected as being comparable with the appellant, it was certainly the United Verde Mining Co., but the bureau has disregarded this. A possible reason for this failure is the lack of technical employees in the special assessment section of the unit. This section has no engineers or technical experts of any kind on its pay roll. The process of picking out comparative companies, which would tax the ability of the best engineers and business experts in the country, is handled by auditors upon whose selection of comparatives depends millions in tax.

STATISTICS ON SPECIAL ASSESSMENT

During the investigation of the bureau the writer assigned two men to secure information as to the comparatives used in special assessment and also as to the appellant companies allowed special assessment.

The bureau also kindly assigned two employees to the work. Certain industries were selected by the writer and the information was prepared for these industries. All of the records were not copied, but the most representative portion of same in regard to the industries chosen was recorded. We believe the statistics compiled may be considered representative and unbiased, as they were compiled by our own employees and the employees of the bureau working in conjunction without interference by the writer as to individual cases which might have influenced the result.

These statistics are voluminous and will not be attached to this report. The summary of same is attached, however, under Exhibit E. This exhibit refers to comparative companies only, as far as the appellant companies (those granted special assessment) are concerned, we shall select certain allowances granted these companies and compare them here with the average of the comparative companies computed in Exhibit E.

MANUFACTURE OF AGRICULTURAL IMPLEMENTS

	Per cent
Average rate profits tax to net income for year 1918 of 17 representative companies	25.4
Cutaway Harron Co. allowed a rate for 1918 of	18.6
Gale Hooper Co. denied relief on a 1918 rate of	49.2

AUTOMOBILE MANUFACTURERS

Average rate profits tax to net income for year 1918 of 19 representative companies	44.1
Republic Motor Truck Co. allowed a rate for 1918 of	27.09
Rowe Motor Truck Co. allowed a rate for 1918 of	29.69
Commercial Motor Truck Co. allowed a rate for 1918 of	37.69
Standard Motor Truck Co. denied relief on a 1918 rate of	60.26

BANKING

1918

Average rate profits tax to net income for year 1918 of 65 representative companies	22. 2
North Side State Bank allowed a rate for 1918 of	14. 97
Greenwood Saving Bank allowed a rate for 1918 of	10. 24
Union Savings & Trust Co. allowed a rate for 1918 of	13. 57
Merchant Bank of Canada allowed a rate for 1918 of	12. 35
Central State Bank denied relief on a 1918 rate of	58. 14
Interstate National Bank denied relief on a 1918 rate of	34. 26

1919

Average rate profits tax to net income for year 1919 of 64 representative companies	8. 9
Celeste State Bank allowed a rate for 1919 of	6. 20
First National Bank, Cheyenne, denied relief on a 1919 rate of	23. 43

NOTE.—American Union Bank of New York was allowed a rate of 11 per cent under special assessment where the statutory rate would have been 37 per cent.

COTTON

1918

Average rate profits tax to net income for year 1918 of 125 representative companies	52. 9
Springstein Mills allowed a rate for 1918 of	21. 11
Barrow County Cotton Mills allowed a rate for 1918 of	36. 79
(9 other companies allowed relief below the general average of 52.9 per cent.)	
Brandon Mills denied relief on a 1918 rate of	66. 40
Riverside Mills denied relief on a 1918 rate of	64. 38
(12 other companies denied relief on rates above the general average of 52.9 per cent.)	

1919

Average rate profits tax to net income for year 1919 of 123 representative companies	20. 9
Holt Williamson & Co. allowed a rate for 1919 of	11. 86
Columbia Cotton Mills allowed a rate for 1919 of	14. 14
Sagamore Manufacturing Co. denied relief on a 1919 rate of	26. 27
Clifton Manufacturing Co. denied relief on a 1919 rate of	24. 21

DEPARTMENT STORES

1918

Average rate profits tax to net income for year 1918 of 138 representative companies	27. 0
Frederick Loser & Co. allowed a rate for 1918 of	25. 08
F. O. Lutz Dry Goods Co. denied relief on a 1918 rate of	51. 67

1919

Average rate of profits tax to net income for year 1919 of 101 representative companies	21. 4
Trask, Prescott & Richardson Co. allowed a rate for 1919 of	19. 84
The Central Store Co. denied relief on a 1919 rate of	34. 44

FARMING

Average rate of profits tax to net income for year 1918 of 20 representative companies	16. 1
Riverview Plantation Co. allowed a rate for 1918 (instead of a statutory rate of 15.3 per cent) of	3. 14

ROLLING COMPANIES

Average rate of profits tax to net income for year 1918 of 22 representative companies	20. 8
Associated Investment Co. allowed a rate for 1918 (instead of a statutory rate of 56.5 per cent) of	11. 87

IRON AND STEEL

Average rate of profits tax to net income for year 1918 of 63 representative companies	50. 2
Bancroft & Martin Rolling Mills allowed a rate for 1918 of	42. 72
Central Tube Co. denied relief on a 1918 rate of	54. 77

STRUCTURAL STEEL

Average rate of profits tax to net income for year 1918 of 62 representative companies	48. 0
Muskogee Iron Works allowed a rate for 1918 of	17. 18
James Lappan Manufacturing Co. denied relief on a 1918 rate of	57. 54

NEWSPAPER PUBLISHERS

1918

Average rate of profits tax to net income for year 1918 of 45 representative companies	20. 3
Swedish American Printing Co. allowed a rate for 1918 of	2. 10
Daily Clarion Ledger Co. allowed a rate for 1918 of	5. 84
Commercial Publishing Co. allowed a rate for 1918 of	14. 07
Wallace Publishing Co. allowed a rate for 1918 of	16. 75
Post Publishing Co. denied relief on a 1918 rate of	44. 64
The Evening Telegraph Publishing Co. denied relief on a 1918 rate of	25. 62

NOTE.—Out of a partial list of 21 newspaper companies applying for special assessment in 1918, 16 have been granted relief by this method and only 5 have been denied relief.

1919

Average rate of profits tax to net income for year 1919 of 55 representative companies	18. 5
The Republican Publishing Co. allowed a rate for 1919 of	2. 22
Globe Printing Co. allowed a rate for 1919 of	11. 72
Wallace Publishing Co. allowed a rate for 1919 of	15. 15
Poughkeepsie Publishing Co. denied relief on a 1919 rate of	26. 50
Troy Record Co. denied relief on a 1919 rate of	27. 29

OIL REFINING

Average rate of profits tax to net income for year 1918 of 60 representative companies	45. 00
The Energine Refining & Manufacturing Co. allowed a rate for 1918 of	17. 59
Petroleum Production Co. denied relief on a 1918 rate of	52. 98

PATENTS AND ROYALTIES

Average rate of profits tax to net income for year 1918 of 53 representative companies	27. 6
American Mercantile Co. allowed a rate for 1918 of	4. 76
Clark Car Co. denied relief on a 1918 rate of	45. 29

RAILWAY COMPANIES

Average rate profits tax to net income for year 1918 of 13 representative companies	18. 3

Allowed under special assessment, 1918

Company	Statutory rate	Assessed rate
	Per cent	*Per cent*
Capital Traction Co., Washington, D. C.	7.7	5.09
Oklahoma, Kansas & Missouri Ry. Co.	39.5	14.12
San Francisco, Nopa & Calistoga Ry	18.1	10.29

INDUSTRY—SHIPBUILDING

Average rate of profits tax to net income for year 1918 of 25 representative companies, 67.8 per cent.

Allowed in 1918 under special assessment

Name	Statutory rate	Rate assessed
	Per cent	*Per cent*
Percy & Small (Inc.)	53.1	42.30
Wilson & Kelz Shipbuilding Co.	65.2	50.82
Globe Shipbuilding Co.	64.7	52.77
United Engineering Co.	67.3	54.89
Theo. A. Crane Sons Co	69.3	62.05
Niagara Motor Boat Co.	72.4	63.04
The Atlantic Works	71.1	63.65
Coloma Marine Ry. Co	68.5	65.40
Seaborn Shipyard Co.	78.6	65.51
Nelin Marine Equipment Co.	79.2	66.96

SHOE MANUFACTURERS

1918

	Per cent
Average rate of profits tax to net income for year 1918 of 25 representative companies	24.1
Thos. K. Ray Co. allowed a rate for 1918 of	16.58
E. P. Reed Co. denied relief on a 1918 rate of	48.40

1919

Average rate of profits tax to net income for year 1919 of 25 representative companies	22.8
Marston & Topley Co. allowed a rate for 1919 of	11.74
Allen-Squire Co. allowed a rate for 1919 of	9.59
Pingree Sons Co. allowed a rate for 1919 of	8.86
G. Edwin Shulte Shoe Co. denied relief on a 1919 rate of	29.31
John R. Donavan Co. denied relief on a 1919 rate of	29.11
Rogers & Briggs (Inc.) denied relief on a 1919 rate of	32.20

STEAMSHIP COMPANIES

Average rate of profits tax to net income for year 1918 of 56 representative companies, 55.5 per cent.

Twelve companies were allowed special assessment for 1918 at rates below the above average.

WOOLEN MANUFACTURES

	Per cent
Average rate of profits tax to net income for year 1918 of 18 representative companies	45.7
William Hollins & Co. (Ltd.) allowed a rate for 1918 of	24.02
Georges River Mill allowed a rate for 1918 of	30.59
Worumbs Manufacturing Co. denied relief on a 1918 rate of	60.04
Souhegan Woolen Co. denied relief on a 1918 rate of	58.68

The above figures show conclusively that the granting of special assessment is not equitable. In order to arrive at the various rates shown the taxpayer does not have to suffer an exceptional hardship, but simply must have some abnormality in his invested capital or income. The words "exceptional hardship" as used in the law we believe expressed the intent of Congress rather than the word "abnormality."

Practically every company in the country can claim insufficient good-will values. The regular provisions of the law definitely prescribe just how good will can be included in invested capital. The bureau's method makes null and void the regular provisions of the act by their interpretation of special assessment.

Practically every concern in the country borrows money from time to time. Why not give them all special assessment or revise the provision of the act excluding borrowed capital from invested capital?

We believe the intent of Congress was to relieve companies from an exceptional hardship in tax, when they were in a distinctly abnormal condition, and when their tax stood out in an exceptional degree proportionately greater than that borne by representative efficient concerns in the same industry.

What equity can be found for instance in allowing one newspaper company a profits tax rate of 2.1 per cent, another 5.8 per cent, another 14 per cent, and another 16.7 per cent by special assessment, and then denying other companies in the same industry relief on rates of 25 and 44 per cent?

REFUND STATISTICS

On request of the committee, the bureau has furnished us with a list of refunds, credits and abatements finally allowed taxpayers, each of which allowances exceed $250,000. The total of these overassessments amount to $169,265,184, but of this amount, the papers furnished by the bureau do not show clearly on what grounds $69,433,177 were allowed on. On the balance of $99,832,007, we do know the grounds of the allowances, and we shall, therefore, assume that the percentage allowed on this later total will hold approximately for the whole amount. The allowances under sections 210 and 327, special assessment, amount to $38,768,702. This shows, therefore, that of all the refunds, credits, and abatements issued by the bureau, the special assessment provision of the act is responsible for 38.83 per cent of this loss to the Government in tax. The next largest allowance is granted on increases made in invested capital, which amounts to 12.48 per cent of the total. The next largest amount is refunded on the basis of amortization which amounts to 6.26 per cent of the total. The above three grounds total 57.57 per cent. The balance of 42.43 per cent is allowed on 35 other grounds which will not be discussed here.

It can be seen from the above figures that there is no question but what the special assessment features of the act have permitted more money to be paid back than any other provision. In fact, our figures show that on this ground the refunds have been three times greater than on any other individual ground. Moreover, claims under special assessment are over one-third of the total allowances.

It appears to have been the intent of Congress that the special assessment provision should only be applied in very exceptional cases, but the above figures would indicate that it is almost exceptional when it is not applied.

We wish to draw attention at this point to the amount of work which is accumulated in the special assessment section, due to the influx of taxpayers claiming relief when they found out how easy it was to be considered under this provision. We are quoting from page 5 of our system report No. 1, dated June 22, 1925, on the subject of "Progress of Income Tax Unit in getting its work current."

"Special assessment section shows a loss in progress on its five years old work, having on hand 6,161 more returns than two years previous, a loss of 269 per cent. This is, of course, highly unsatisfactory, but we believe it is not entirely the fault of the section, it is due to a lot of taxpayers rushing in with special assessment claims when they cloudn't get all they wanted under the regular provisions of the law."

From the inventory of cases on hand in March 1923, it appears that there were 9,974 cases in special assessment. From the inventory two years later, March 1925, it appears that there were 13,428 cases on hand in the special assessment section. While these figures, of course, do not indicate the amount of work handled during the year by this section, it is certain, due to the efforts they make to keep the work current, that a constantly increasing number of cases have been handled from year to year under the special assessment provisions of the act. We contend that if these provisions of the act had been interpreted strictly and within the intent of Congerss to relieve cases where exceptional hardship were concerned, then no such condition would have existed. The number of cases passed by this section is in itself proof of the very liberal interpretation given to this section of the law.

We are appending herewith, under Exhibit F, a list of overassessments granted on account of special assessment section of the law. This list, as before noted, shows a total of $38,768,702. We will discuss very briefly a few of these allowances, basing our argument on the rather meager information at hand.

R. J. REYNOLDS TOBACCO CO., WINSTON-SALEM, N. C.

The above company has been allowed abatements and credits amounting to $1,698,265 for the year 1918. Their statutory tax would have amounted to $10,226,521, this has been reduced under section 328 to $8,528,256. The percentage of final profits tax to net income amounts to 40 per cent. From the list of comparative tobacco companies available, from the records of the bureau, we find that eight tobacco companies paid a higher rate of tax than 40 per cent. If we remember that this was a war year, in which the industries were supposed to be taxed to the utmost, we can not see an exceptional hardship for a company which makes practically $18,000,000 to pay 50 per cent of this in profits tax. If it had not been intended by Congress for anybody to pay this rate, why were the 65 and 80 per cent brackets established at all?

AMERICAN CAR & FOUNDRY CO., NEW YORK, N. Y.

This company has been refunded and abated under section 328 of the act of 1918, the amount of $5,209,204 on account of its 1918 tax. The next income of this taxpayer was $37,443,246, the final profits tax under special assessment was $17,244,552, the final percentage of profits tax to net income amounted to 46 per cent.

We would call attention to the fact that the United States Steel Corporation, an allied industry, was in the 80 per cent bracket in 1918, and paid a total tax amounting to about 82 per cent of their net income. We do not believe that it was the intent of Congress to hand back these large companies an amount of $5,000,000 on account of their excessive war profits. The data submitted by the department shows that 95.44 per cent of the net income of this taxpayer came from war contracts, but it does not state whether they were on the cost plus basis or not. We wish to draw attention to that section of the act which provides that corporations "in which 50 per cent or more of the gross income * * * consists of gains, profits * * * derived on a cost plus basis from a Government contract," is excluded from a right of treatment by special assessment. Whether or not this company is technically excluded or not we do not know, but we do think that the general intent of the provision was not to grant relief to such companies.

YOUNGSTOWN SHEET & TUBE CO., YOUNGSTOWN, OHIO

This company has received refunds, credits and abatements amounting to $3,482,610 from a statutory tax amounting to $19,469,794. The consolidated net income of this company was $38,977,014. The above allowance was for the taxable year 1917.

It appears that this claim was originally disallowed by the unit, but was allowed by the committee on appeals and review. It would apear that the invested capital of the taxpayer could have been determined and in fact was determined. As contended several times before in this report, we do not admit that the policy of the bureau in making retrospective provisions of the 1918 act, concerning abnormality, is sound for the year 1917.

NORTHWEST STEEL CO, PORTLAND, OREG.

We have already reported on the amortization details of the above taxpayer's case. It is interesting to note that for the year 1917 this corporation's taxes have been reduced from $1,380,692 to $457,456, indicating refunds, credits and abatements of $923,236, under special assessment. In view of our previous study of this case, we do not understand why this taxpayer's invested capital could not have been determined for the year 1917.

PITTSBURGH STEEL PRODUCTS CO., PITTSBURGH, PA.

This company has received a relief in taxation amounting to the difference between the statutory tax of $4,698,161 and a tax determined under special assessment of $2,867,934, a net refund to the company of $1,830,227 for the year 1918.

These figures speak for themselves, but it might also be noted that this company received an amortization allowance which reduced their net income by $2,051,215.

The above cases show plainly the very large measure of relief afforded companies by the bureau's method of determining the tax under special assessment.

Legislative History of Special Assessment Provision

So much detail has been given showing the method employed by the bureau in determining special assessment that we feel it necessary to give a brief history of the special assessment provision in order to throw a little light on the intent of Congress in this matter.

We have already quoted from section 210 of the revenue act of 1917, covering special assessment. We believe this provision was sound and reasonable inasmuch as it only applied to cases where the invested capital of the taxpayer could not be satisfactorily determined. The rewording of this provision, under section 327 of the revenue act of 1918 is what has caused the trouble. This section originally read as follows, in House of Representatives bill No. 12863:

[Cong. Rec. vol. 57, p. 307, year 1918]

"(a) That in the following cases the invested capital shall be determined as provided in subdivision (b) of this section: (1) Where the commissioner is unable satisfactorily to determine the invested capital as provided in section 326; or (2) where a mixed aggregate of tangible property and intangible property has been paid in for stock or for stock and bonds and the commissioner is unable satisfactorily to determine the respective values of the several classes of property at the time of payment, or to distinguish the classes of property paid in for stock and for bonds respectively; or (3) where capital is a material income-producing factor, but where, because of the fact that the capital employed is in large part borrowed, there is no invested capital or the invested capital is materially disproportionate to the net income as compared with representative corporations engaged in a like or similar trade or business. This section shall not apply in the case of a corporation 50 per cent or more of whose gross income (as defined in section 213 for income-tax purposes) consists of gain, profits, or commissions derived from Government contracts, unless the commissioner is satisfied that such corporation is overcapitalized.

"(b) In the cases specified in subdivision (a) the invested capital shall be the amount which bears the same ratio to the net income of the corporation for the taxable year as the average invested capital for the taxable year of representative corporations engaged in a like or similar trade or business bears to their average net income for such year."

The wording of this section was amended in the Finance Committee of the Senate by amendment No. 263. This amendment went into considerable detail, but will not be quoted here as the final wording of the act was fixed in conference as shown by the following quotation:

[Cong. Rec., vol. 57, pt. 3, 65th Cong., 3d sess., Jan. 27–Feb. 11, 1919, p. 3124 Cong. Rec., Senate Feb. 11, 1919]

EXTRACT FROM CONFERENCE REPORT

"Amendment numbered 263: That the House recede from its disagreement to the amendment of the Senate numbered 263, and agree to the same with an amendment as follows: In lieu of the matter inserted by said amendment insert the following:

"'That in the following cases the tax shall be determined as provided in section 328:

"'(*a*) Where the commissioner is unable to determine the invested capital as provided in section 326;

"'(*b*) In the case of a foreign corporation;

"'(c) Where a mixed aggregate of tangible property and intangible property has been paid in for stock or for stock and bonds and the commissioner is unable satsifactorily to determine the respective values of the several classes of property at the time of payment, or to distinguish the classes of property paid in for stock and for bonds, respectively;

"'(d) Where upon application by the corporation the commissioner finds and so declares of record that the tax, if determined without benefit of this section, would, owing to abnormal conditions affecting the capital or income of the corporation, work upon the corporation an exceptional hardship evidenced by gross disproportion between the tax computed without benefit of this section and the tax computed by reference to the representative corporations specified in section 328. This subdivision shall not apply to any case (1) in which the tax (comput... without benefit of this section) is high merely because the corporation ear...d within the taxable year a high rate of profit upon a normal invested capital, nor (2) in which 50 per cent or more of the gross income of the corporation for the taxable year (compared under section 233 of Title II) consists of gains, profits, commissions, or other income, derived on a cost-plus basis from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive.'"

It appears from the above that the original intent of the bill was to give relief to companies having an unusual amount of borrowed capital; it was recognized later, however, that certain other cases of oppressive taxation might be developed and that the final wording was really intended to give the bureau a free hand in cases where an "exceptional hardship" would be worked.

We are quoting herewith from the Congressional Record certain remarks by Senator Smoot in regard to the relief provisions of the revenue act, among which is included the special-assessment provision.

[Extracts from Congressional Record, Dec. 16, 1918, page 507, vol. 57, Pt. I. Senator Smoot on relief provisions of revenue act (H. R. 12863).]

INVESTED CAPITAL

Section 327 (d), page 99, lines 20-24, provides that the profits tax shall be determined on the basis of representative corporations (without regard to the invested capital of the taxpayer).

"(d) Where, as compared with representative corporations, engaged in a like or similar trade or business, the taxpayer would (under sec. 326) be placed in a position of substantial inequality, because of the time or manner of organization."

Mr. SMOOT. Mr. President, those are the relief provisions as provided in the bill. Some of them are very sweeping in their scope, and if not administered by the department in absolute fairness will work an unjust discrimination against the business of the country. I want Senators to know that in these provisions there is placed in the hands of the Commissioner of Internal Revenue or the Secretary of the Treasury, as the case may be, a power that has never been granted to department officials before. If exercised wisely it will be a relief to the institutions of the country, and many of them will need it, but if exercised unjustly or unwisely there will be a frightful discrimination between business concerns and industries of the country.

This quotation proves conclusively that the Senate was aware of the very great power conferred on the bureau by this provision of the revenue act, but at the same time it shows that they expected the bureau to administer the act with extreme care.

CONCLUSIONS

From our investigation of the subject of special assessment, we conclude as follows:

1. That the bureau has made retroactive the provisions of section 327 and 328 of the 1918 act as modifying section 210 of the 1917 act without authority.
2. That no scientific basis has been set up for determining when a company is entitled to special assessment.
3. That no scientific basis has been set up for determining the amount of such special assessment when the right to same can be properly granted.
4. Grounds for special assessment allowed by the bureau result in making null and void those provisions of the act limiting the allowance of good will values in invested capital, excluding borrowed capital from invested capital,

providing for the taxation of capital gains due to appreciation in value from March 1, 1913, and providing for the valuation of stock issued on reorganization.

5. We conclude that the prediction of Senator Smoot has been borne out and that due to the bureau's method of administering special assessment there has been "a frightful discrimination between business concerns and industries of the country."

RECOMMENDATIONS

It has been stated by high officials of the bureau that Congress should never have imposed on the commissioner the duty of administering such a provision of the act as special assessment. In other words, they admit that they are practically helpless in administering this section properly. We contend that a strict interpretation of this provision, which would limit the relief afforded to cases of extraordinary hardship, would have enabled the bureau to administer this section of the act with proper equity.

In view of the fact that the time available for the investigation of this section of the Income Tax Unit was limited, we are obliged to make our recommendations in general form as follows:

1. That a complete review of all cases already computed or pending in the special assessment section and not absolutely closed should be made.
2. The grounds for admitting a company to special assessment should be accurately determined and approved by the solicitor's office and the commissioner.
3. A scientific basis for selecting comparatives should be set up which would take due account of the maximum rate of tax paid by representative concerns in a given industry, and would also take due account of the time of organization. The present system of selecting comparatives, mainly on account of their size, should be to considerable extent disregarded in order that we may not make the small companies pay more tax than the large companies as results from the present system.
4. All cases where special assessment is granted should be reviewed by an independent reviewing body, subject directly to the commissioner instead of to the deputy commissioner in charge of the Income Tax Unit.
5. The grounds for admitting to special assessment and the method of computing same should be published for the information of the taxpayer. At present the taxpayer can not properly set up a special assessment claim without inside information.
6. The commissioner should be called on for the record of all cases in which the tax has been determined under section 328 of the revenue acts of 1918 and 1921, as provided for in this section itself.

In closing our report on this subject, we wish to make clear that the time available for the investigation of this feature of the revenue act was not sufficient for as thorough and complete a study as the importance of the subject demands. We hope we have brought out that the special assessment section of the bureau has it within their power to hand back millions in taxes by the stroke of a pen. If a company makes $38,000,000 and has to pay a tax of $19,000,000, the tax looks high so the bureau finds a way to hand the taxpayer back $5,000,000. It is a big tax, but surely Congress would not have set up an 80 per cent bracket in 1918 if it did not expect anybody to be taxed at this rate.

The bureau appears to have forgotten that there was a World War in 1918, that our boys were giving their lives for their country in foreign lands, and that the industries of the country were also supposed to do their part by contributing the larger portion of their profits. Surely, lives are as important as dollars, and too much sympathy should not be given to large companies whose very profits depended in a large measure to the extraordinary demands for production in nearly all lines. The bureau has also forgotten, that inasmuch as taxes are necessary in a fixed amount to meet the expenses and obligations of the Government, then every dollar improperly refunded to a taxpayer, means another dollar taken away from the present taxpaying public. The allowances under the excuse of special assessment look very much like grand larceny from our present day taxpayers.

Respectfully submitted.

L. H. PARKER, *Chief Engineer.*

EXHIBIT A

JUNE 26, 1925.

To: L. C. Manson, general counsel.
From: L. H. Parker, chief engineer.
Office memorandum No. 19-A.
Taxpayer: J. H. Hillman & Sons (Inc.).
Subject: Special assessment 1917 tax.

SYNOPSIS OF CASE

The case of the J. H. Hillman & Sons was presented to the committee in our office memorandum No. 19. While the fraud and compromise features of the case were gone into at some length, the special assessment features were merely mentioned. Subsequent investigation in regard to special assessment allowed this taxpayer under section 210 of the 1917 act forces us to the following conclusions:

1. There were no proper grounds for granting this taxpayer relief by special assessment in 1917.
2. Only two comparatives were used in determining the ratio of profit tax to net income, instead of the usual five comparatives.
3. Five comparatives were available and in fact set up on a work sheet, the two used had the lowest rates, and hence were most advantageous to taxpayer.
4. The comparatives discarded were thrown out on the basis of being smaller sized companies. In other words, small companies should, according to the bureau, pay more than large companies.

After the fraud penalty had been assessed in this case, upon application of taxpayer, the case was admitted to treatment by the special assessment section. As 1917 taxes were involved, this then came under section 210 of the act of 1917.

The reason assigned for granting taxpayer any relief under this section was not given in writing and is not perfectly clear. From verbal information secured in the section on May 29, 1925, it would appear that the principal reason for giving special assessment was the extraordinary personal business genius of Mr. Hillman.

From the files of the special assessment section, it appears that a work sheet listing five comparatives in the coal brokerage business was first set up. The results of this comparison was about as follows:

Comparative No.	Gross income	Per cent profit tax to net income
1	$6,300,000	36
2	19,200,000	38
3	5,000,000	40-48
4	2,000,000	
5	2,000,000	

All the above figures are approximate and from memory.

The gross income of the J. H. Hillman Co. was $20,200,000 and the statutory ratio of profits tax to net income was 55 per cent. On the basis of the five comparatives the Hillman Co. should have paid at least 42 per cent. This was not done, however, the last three comparatives were discarded on the basis of being too small in size and the following final work sheet set up.

Comparatives	Invested capital	Net income	Gross income	Per cent profits tax to net income
1. Franklin Coal Co., Chicago, Ill.	$2,173,301	$1,084,949	$6,345,000	36.37
2. C. Reiss Coal Co., Sheboygan, Wis.	3,831,984	2,126,693	19,200,000	38.18
Average				37.28
Appellant company (Hillman)	1,349,560	3,470,911	20,200,000	55.01

It was finally determined, therefore, by the unit that the J. H. Hillman Co. was to pay $37.3 per cent profits tax on its net income instead of the statutory rate, which in this case would have figured out as 55.01 per cent. This determination may possibly not be approved by the solicitor's office, but it is finally recommended by the Income Tax Unit.

DISCUSSION OF CASE

We take exception in this case to granting any relief to this taxpayer under section 210 of the act of 1917. This section provides "That if the Secretary of the Treasury is unable in any case satisfactorily to determine the invested capital, the amount of deduction shall be the sum of (1) an amount equal to the same proportion of the net income of the trade or business received during the taxable year as the proportion which the average deduction for the same calendar year of representative corporations, partnerships, and individuals engaged in a like or similar business bears to the total net income of the trade or business received by such corporations, partnerships, and individuals plus (2) in the case of a domestic corporation $3,000 and in the case of a domestic partnership or a citizen or resident of the United States $6,000.

This provision was carried on in the 1918 act, under sections 327 and 328, but the relief afforded individuals and partnerships was cut out, but the wording liberalized for corporations so that relief could be granted to cover "abnormal conditions." However, sections 327 and 328 of the 1918 act were not retroactive.

As far as 1917 is concerned, the only grounds for granting special assessment in this case that we can see would be in the event the bureau "was unable satisfactorily to determine the invested capital." But, the bureau was able and in fact did compute the invested capital of the taxpayer. We contend that granting the taxpayer special assessment on the ground that the personal business genius of Mr. Hillman allowed the company to get along with a very small capital is ridiculous for the year 1917 at least. Of course, the 55 per cent tax was high, but that rate is high for any company and if the law provides for a 60 per cent bracket, surely the bureau shouldn't let everybody out with a 40 per cent tax through special assessment. We believe that if the Hillman Co. got relief under this section, then every big company in the country ought to get relief on the basis of their business genius. Certainly on this basis the United States Steel Co. should have been relieved of its very high rates of tax on account of the extraordinary business genius of Judge Gary and other directors of the company.

In relation now to selecting only two comparatives in this case, we believe this is unsound. The regular practice is to select five. It is our opinion, however, that the real intent of Congress was to allow the commissioner to set up a perfectly definite ratio between the profits tax and the net income, for use in cases where the invested capital could not be determined, by taking the average of the whole representative group of companies in a particular business. Quoting from section 210 of the revenue act of 1917, we leave this matter for legal interpretation:

"For the purpose of this section the proportion between the deduction and the net income in each trade or business shall be determined by the Commissioner of Internal Revenue in accordance with regulations prescribed by him, with the approval of the Secretary of the Treasury."

It is our opinion that Congress intended a perfectly definite ratio to be set up and granted alike to the taxpayer in the same trade or business whose invested capital could not be determined.

We wish to draw attention to the effect of selecting comparatives in the way it was done in this case. Five comparatives were available but as before stated, three were thrown out on the basis of being too small in size. The two larger companies, which were used as comparatives, paid the lowest percentage of profits tax to net income. If the five companies had been used, about $100,000 more in tax would have been collected from taxpayer.

Where such a system leads us can be shown by the following hypothetical case:

Two coal brokerage houses are located in Pittsburgh; they are competitors, but one is an old established house making $3,000,000 per year and the other is a small house making $100,000 per year. We will assume the invested capital of neither can be determined. Now, under the bureau's method we must compare the large company with two other large companies. These large companies have ample capital and pay an average rate of tax of 37 per cent. The small company must be compared with five small companies. These companies naturally in a good year (as in 1917) extend their business to the utmost and hence show a larger earning in proportion to their invested capital than the large companies. The smaller companies pay an average rate of 48 per cent. The bureau then determines that for these two companies, which are similar in every way except in size, the large company needs to pay only 37 per cent profits tax and its small competitor must pay 48 per cent profits tax. We condemn this system of discrimination against the small taxpayer. It defeats the very purpose of the act, which was to give rivals in like businesses a fair and just chance to compete with each other on an equal basis.

CONCLUSION

We must conclude from the foregoing that the application of section 210, revenue act of 1917 (special assessment) is not in accordance with the intent of Congress. The policy of the bureau in this as in other cases may best be summed up by the following biblical quotation:

"To him that hath shall be added unto, and from him that hath not shall be taken away even that which he hath."

Respectfully submitted.

L. H. PARKER, *Chief Engineer.*

EXHIBIT B

Income tax (technical) special assessment section—Comparative statistics re Groves Mills

[Nature of business: Manufacturing cotton yarns]

	Apellant (North Carolina)	Comparative No. 1 (Alabama)	Comparative No. 2 (North Carolina)	Comparative No. 3 (North Carolina)	Comparative No. 4 (North Carolina)	Comparative No. 5 (South Carolina)	Comparative No. 6.	Average comparative
Invested capital as adjusted	$384, 836	$352, 895	$300, 000	$394, 176	$345, 625	$555, 177	....	$389, 575
Gross sales	955, 274	1, 013, 784	869, 672	770, 963	670, 132	913, 189	....	847, 548
Other income	2, 292	1, 415	155	1, 216	2, 287	2, 245	....	....
Cost of goods sold	692, 960	788, 889	631, 788	560, 278	478, 250	648, 224	....	621, 480
Ordinary and necessary expenses	5, 914	32, 102	75, 747	....	2, 423	14, 458	....	....
Compensation of officers	44, 991	12, 000	4, 200	5, 400	13, 725	6, 800	....	....
Repairs	....	....	919	3, 817	7, 695	5, 397	....	....
Interest	9, 880	8, 357	16, 110	3, 604	10, 321	11, 251	....	....
Taxes	2, 961	3, 591	5, 843	2, 800	5, 524	5, 423	....	....
Bad debts	....	....	....	250	....	50	....	....
Exhaustion, wear and tear (including obsolescence)	30, 132	28, 658	22, 397	15, 703	34, 913	40, 872	....	....
Net income	172, 565	145, 201	112, 847	182, 042	124, 393	166, 994	....	146, 295
Percentage of net income to gross sales	18. 07	14. 32	12. 98	23. 61	18. 56	18. 29	....	17. 26
Percentage of net income to adjusted invested capital	44. 84	41. 15	37. 62	46. 18	35. 99	30. 08	....	37. 55
Percentage of cost of sales to gross sales	72. 54	77. 82	72. 65	72. 67	71. 37	70. 99	....	73. 33
Excess profits	$33, 787	....	....	....	....	....	....	....
War profits	41, 484	....	....	....	....	....	....	....
Profits tax	$104, 864	$85, 529	$63, 878	$100, 986	$68, 560	$86, 781	....	$81, 147
Percentage	60. 76	58. 90	56. 61	55. 47	55. 12	51. 97	....	55. 47

Final profits tax, appellant	$90, 568. 44
Per cent of final tax to net income, appellant	57. 70
Constructed invested capital, appellant	$451, 042. 30

EXHIBIT C

Adams Woolen Co.—Bureau's determination, 1919

	Appellant (Massachusetts)	Comparative No. 1 (Connecticut)	Comparative No. 2 (Virginia)	Comparative No. 3 (Maine)	Comparative No. 4 (Connecticut)	Comparative No. 5 (New York)	Comparative No. 6 (Massachusetts)	Average comparative
Invested capital	$177,159	$351,881	$618,085	$314,282	$640,333	$830,949	$631,155	$564,448
Gross sales	1,226,304	1,006,749	1,253,408	841,240	2,128,511	1,892,908	949,681	1,345,416
Net income	243,194	250,280	263,712	147,328	290,730	344,008	221,724	252,964
Per cent net income to gross sales	19.83	24.86	21.04	17.51	13.66	18.17	23.35	18.80
Per cent net income to invested capital	137.27	71.12	42.67	46.88	45.40	41.40	35.13	44.84
Profits tax	$86,757	$79,806	$70,272	$40,731	$79,833	$90,470	$52,745	$68,976
Per cent profits tax to net income	35.71	31.89	26.65	27.65	27.46	26.30	23.79	27.27
Final profit tax appellant	$66,269							
Per cent of final profit tax to net income	27.25							
Constructed invested capital	$543,002							

SUBSTITUTE DETERMINATION NO. 1

	Appellant (Massachusetts)	Comparative No. 1 (Connecticut)	Comparative No. 2 (New Hampshire)	Comparative No. 3 (Maine)	Comparative No. 4 (Connecticut)	Comparative No. 5 (New Hampshire)	Comparative No. 6 (New York)	Average comparative
Invested capital	$177,159	$351,881	$371,520	$314,282	$640,333	$425,289	$158,193	$376,916
Gross sales	1,226,304	1,006,749	1,243,281	841,240	2,128,511	1,355,672	1,023,797	1,266,541
Net income	243,194	250,280	453,073	147,328	290,730	258,692	144,932	257,505
Percentage of net income to gross sales	19.83	24.86	36.44	17.51	13.66	19.08	14.16	20.33
Percentage of net income to invested capital	137.27	71.12	121.95	46.88	45.40	60.83	91.62	68.32
Profits tax	$86,757	$79,806	$159,824	$40,731	$79,833	$79,060	$48,514	$81,294
Percentage of profits tax to net income	35.71	31.89	35.28	27.65	27.46	30.57	33.47	31.57
Final profit tax appellant	$76,717							
Percentage of final profit tax to net income	31.55							
Constructed invested capital	$356,439							

SUBSTITUTE DETERMINATION NO. 2

	Appellant (Massachusetts)	Comparative No. 1 (Connecticut)	Comparative No. 2 (New Hampshire)	Comparative No. 3 (Virginia)	Comparative No. 4 (Connecticut)	Comparative No. 5 (New York)	Comparative No. 6 (Massachusetts)	Average comparative
Invested capital	$177,159	$829,472	$773,142	$618,085	$640,333	$830,949	$631,155	$720,522
Gross sales	1,226,304	1,476,189	1,124,875	1,253,408	2,128,511	1,892,908	949,681	1,470,928
Net income	243,194	192,379	145,902	263,712	290,730	344,008	221,724	243,076
Per cent of net income to gross sales	19.83	13.03	12.97	21.04	13.66	18.17	23.35	16.53
Per cent of net income to invested capital	137.27	23.19	18.87	42.67	45.40	41.40	35.13	33.74
Profits tax	$86,757	$29,901	$16,210	$70,272	$79,833	$90,470	$52,745	$56,572
Per cent of profits tax to net income	35.71	15.54	11.11	26.65	27.46	26.30	23.79	23.27
Final profit tax appellant	$56,589							
Per cent of final profit tax to net income	23.27							
Constructed invested capital	$715,867							

EXHIBIT D.—*Special assessment case No. 1.—Appellant company, Kingan & Co. (Ltd.), Indianapolis, Ind., taxable year 1918*

	Appellant company	Comparative No. 1	Comparative No. 2
Invested capital		$7,710,206	$4,065,698
Gross sales	$63,559,910	53,953,642	31,669,185
Interest	211,599	425,271	203,597
Net income	2,718,468	1,279,086	647,907
Profits tax		463,021	96,809
Per cent profits tax to net income		36.20	14.94
Average per cent of profits tax to net income used for appellant company	29.05		
Profits tax as determined	$789,715		

Grounds for admitting company to special assessment: Company is a foreign corporation.

General remarks.—There is no question but what this company should be granted special assessment under section 327 of the revenue act of 1918, because it is a foreign corporation, and it was especially provided in this section of the act that taxes of foreign corporations should be determined under the special assessment provisions. It is customary to use five comparatives in determining special assessment. It will be noted that in this case only two were used. In order to show how easily the tax may be changed by selecting other comparatives when only two are used, a recomputation of this case changing one of the comparatives, same being selected from the records of the special-assessment section covering the standard comparatives used for the meat-packing industry, is made as follows:

	Appellant company	Comparative No. 1	Comparative No. 2
Invested capital		$7,710,206	$1,173,718
Gross sales	$63,559,910	$53,953,642	$26,459,663
Net income	$[illegible]718,468	$1,279,086	$416,516
Profits tax		$463,021	$161,168
Per cent profits tax to net income		36.20	38.70
Average per cent of profits tax to net income used for appellant company	36.8		
Profits tax by this selection	$1,000,396		
Additional tax with these comparatives	210,681		

EXHIBIT E

Summary of statistical data from special assessment section—Representative companies used as comparatives

Industry	Number of companies	Year	Gross income	Depreciation	Amortization	Depletion	Net income	Net operating income	Per cent depreciation to net operating income	Per cent amortization to net operating income	Per cent depletion to net operating income	Profits tax	Per cent profits tax to net income	Invested capital	Per cent net income to invested capital
Agricultural implements	18	1918	$142,782,534	$1,669,040	$888,533	$50,000	$15,773,691	$18,371,264	9.0	4.5	0.3	$4,013,172	25.4	$107,822,548	14.6
Do	17	1919	79,935,412	1,165,499	7,521		5,076,669	6,249,689	18.6	0.1		467,792	9.2	31,061,517	16.3
Do	4	1920	1,938,696	19,844			169,223	189,067	10.5			10,826	6.4	1,268,719	13.1
Total			224,656,642	2,844,383	896,054	50,000	21,019,583	24,810,020	11.5	3.6	.2	4,491,790	21.3	140,193,084	15.0
Aeroplane manufacture		1918	4,641,902	29,425	215,044		494,109	738,578	4.0	29.1		290,701	58.8	712,405	69.4
Do		1919	3,863,102	177,514			1,573,899	1,751,413	10.1			127,260	8.1	14,883,687	10.6
Total			8,505,004	206,939	215,044		2,068,008	2,489,991	8.3	8.6		417,961	20.2	15,596,092	13.3
Automobile manufacture	19	1918	440,628,676	7,160,132	808,225		53,826,714	61,795,071	11.6	1.3		23,724,620	44.1	184,177,103	29.2
Do	19	1919	394,629,709	4,646,856	62,754		38,189,187	42,898,797	10.8	.2		8,366,261	21.9	165,786,901	23.0
Total			835,258,385	11,806,988	870,979		92,015,901	104,693,868	11.3	.8		32,090,881	34.9	349,964,004	26.3
Banking	65	1918	90,786,320	783,125			33,203,809	33,986,934	2.3			7,362,007	22.2	242,616,019	13.7
Do	64	1919	112,371,770	876,726	165,009		37,917,756	38,959,491	2.3	.4		3,362,796	8.9	261,638,408	14.5
Do	64	1920	45,029,810	383,487			11,121,422	11,504,909	3.3			949,102	8.5	79,986,337	13.9
Total			248,187,900	2,043,338	165,009		82,242,987	84,451,334	2.4	.2		11,673,905	14.2	584,240,755	14.1
Cement manufacture	23	1918	65,977,119	4,797,615	114,285	261,506	10,875,709	16,049,115	29.9	.7	1.6	1,079,917	9.9	84,626,040	12.9
Do	20	1919	72,963,935	3,217,758		170,326	10,148,871	13,536,955	23.8		1.3	710,405	7.0	85,245,354	11.9
Do	19	1920	66,571,027	3,188,028		41,577	7,724,909	10,954,514	29.1		.4	441,752	5.7	74,749,698	10.3
Total			205,512,081	11,203,401	114,285	473,409	28,749,489	40,540,584	27.6	.3	1.2	2,232,074	7.8	244,621,072	11.8

Summary of statistical data from special assessment section—Representative companies used as comparatives—Continued

Industry	Number of companies	Year	Gross income	Depreciation	Amortization	Depletion	Net income	Net operating income	Per cent depreciation to net operating income	Per cent amortization to net operating income	Per cent depletion to net operating income	Profits tax	Per cent profits tax to net income	Invested capital	Per cent net income to invested capital
Coal, coke, iron, and steel	12	1918	$149, 597, 957	$1, 637, 944	$3, 113, 585	$2, 512, 967	$14, 833, 590	$22, 098, 086	7.4	14.1	11.4	$1, 861, 173	12.7	$142, 210, 631	10.4
Do	4	1919	52, 880, 951	1, 807, 595		2, 270, 004	7, 053, 453	11, 131, 652	16.2		20.4	336, 506	4.8	54, 774, 473	12.9
Do	2	1920	34, 259, 820	487, 594	125, 000	783, 843	4, 265, 171	5, 661, 608	8.6	2.2	13.8	372, 588	8.7	33, 065, 352	12.9
Total			236, 737, 828	3, 933, 133	3, 238, 585	5, 566, 814	26, 152, 214	38, 890, 746	10.1	8.3	14.3	2, 590, 267	9.9	230, 050, 456	11.4
Copper mining	16	1918	91, 115, 324	3, 443, 389	590, 324	10, 398, 798	23, 068, 947	37, 501, 458	9.2	1.6	27.7	5, 490, 883	23.8	164, 314, 959	14.0
Do	5	1919	21, 202, 062	518, 226	21, 439	1, 881, 701	3, 500, 097	5, 921, 463	8.8	.4	31.8	353, 004	10.4	25, 679, 019	13.6
Do	1	1920	7, 043, 873	337, 004		178, 720	2, 193, 432	2, 709, 156	12.4		6.6	179, 600	8.2	16, 155, 387	13.6
Total			119, 361, 259	4, 298, 619	611, 763	12, 459, 219	28, 762, 476	46, 132, 077	9.3	1.3	27.0	6, 033, 487	21.0	206, 149, 365	14.0
Cotton	125	1918	334, 121, 312	7, 448, 988	1, 207, 567	4, 893	51, 254, 369	59, 915, 817	12.4	2.0	01	27, 132, 080	52.9	156, 465, 503	32.8
Do	123	1919	275, 198, 107	6, 037, 982	1, 524, 282		47, 923, 159	55, 485, 423	10.9	2.7		10, 013, 486	20.9	168, 908, 632	28.4
Do	53	1920	126, 349, 721	2, 794, 345			20, 088, 167	22, 882, 512	12.2			4, 695, 319	23.4	67, 100, 546	29.9
Total			735, 669, 140	16, 281, 315	2, 731, 849	4, 893	119, 265, 695	138, 283, 752	11.8	2.0		41, 840, 885	35.1	392, 474, 681	30.4
Department stores	138	1918	537, 037, 971	3, 962, 380	1, 048		43, 903, 822	47, 867, 250	8.3	.002		11, 842, 221	27.0	227, 178, 049	19.3
Do	101	1919	284, 812, 568	2, 370, 295	303, 352	3, 308	28, 947, 904	31, 624, 859	7.5	1.0	01	6, 196, 884	21.4	102, 347, 361	28.3
Do	73	1920	226, 816, 880	1, 877, 279	8, 186	44, 529	18, 279, 698	20, 209, 692	9.3	.04	.02	3, 423, 243	18.7	80, 312, 235	22.8
Total			1, 048, 667, 419	8, 209, 954	312, 586	47, 837	91, 131, 424	99, 701, 801	8.2	.3	03	21, 462, 348	23.6	409, 837, 645	22.2
Drop forgings	49	1918	59, 161, 696	1, 597, 075	837, 016	52	7, 908, 325	10, 342, 468	15.4	8.1		3, 301, 328	41.7	29, 718, 338	26.6
Do	40	1919	53, 318, 807	1, 401, 311	514, 144	14, 695	7, 762, 680	9, 692, 830	14.5	5.3	.2	1, 712, 008	22.1	30, 743, 562	25.2
Do	7	1920	10, 384, 977	237, 134			1, 081, 774	1, 318, 908	18.0			129, 393	12.0	6, 018, 906	18.0
Total			122, 865, 480	3, 235, 520	1, 351, 160	14, 747	16, 752, 779	21, 354, 206	15.2	6.3	.1	5, 142, 729	30.7	66, 480, 806	25.2
Dyes	11	1918	65, 128, 932	2, 147, 413	4, 042, 029		6, 069, 289	12, 258, 731	17.5	33.0		741, 141	12.2	48, 526, 657	12.5
Do	11	1919	49, 904, 438	3, 510, 037	2, 050, 000		6, 473, 076	12, 033, 113	19.2	17.0		634, 065	9.8	43, 807, 342	14.8
Do	9	1920	11, 836, 196	57, 100			829, 436	886, 536	6.4			192, 319	23.2	3, 073, 374	27.0
Total			126, 869, 566	5, 714, 550	6, 092, 029		13, 371, 801	25, 178, 380	22.7	24.2		1, 567, 525	11.7	95, 407, 373	14.0

Farming	20	1918	4, 080, 456	113, 618		2, 153	843, 827	959, 598	11. 8		. 2	136, 162	16. 1	6, 528, 428	12. 9
Do	20	1919	6, 897, 897	175, 076		888	2, 026, 281	2, 202, 245	7. 9		. 04	280, 616	13. 8	11, 089, 143	18. 3
Do	9	1920	1, 171, 948	30, 187		5, 616	141, 255	177, 058	17. 0		3. 2	7, 111	5. 0	1, 024, 772	13. 8
Total			12, 150, 301	318, 881		8, 657	3, 011, 363	3, 338, 901	9. 6		. 3	423, 889	14. 1	18, 652, 343	16. 1
Foundry and castings (iron and steel)	62	1918	178, 642, 465	3, 910, 547	1, 176, 630	60, 237	34, 938, 697	40, 086, 111	9. 8	2. 9	. 2	19, 685, 082	56. 4	81, 737, 436	42. 7
Do	61	1919	142, 017, 214	2, 803, 035	1, 001, 032	19, 823	21, 480, 468	25, 304, 358	11. 1	4. 0	. 1	4, 223, 227	19. 7	105, 684, 424	20. 3
Do	60	1920	150, 699, 855	1, 602, 121		8, 703	15, 684, 292	17, 295, 116	9. 3		. 1	1, 741, 474	11. 1	102, 466, 553	15. 3
Total			471, 359, 534	8, 315, 703	2, 177, 662	88, 763	72, 103, 457	82, 695, 585	10. 1	2. 6	. 1	25, 650, 783	35. 6	289, 888, 413	24. 9
Gas company	12	1918	20, 502, 469	319, 935	243, 840	48, 287	2, 849, 436	3, 461, 498	9. 2	7. 0	1. 4	275, 086	9. 7	30, 656, 961	9. 3
Do	12	1919	7, 719, 666	503, 858		21, 029	736, 012	1, 260, 899	40. 0		1. 7	41, 367	5. 6	7, 196, 446	10. 2
Do	7	1920	3, 418, 948	162, 651			545, 825	708, 476	23. 0			32, 961	6. 0	4, 504, 891	12. 1
Total			31, 641, 083	986, 444	243, 840	69, 316	4, 131, 273	5, 430, 873	18. 2	4. 5	1. 3	349, 414	8. 5	42, 358, 298	9. 8
Holding company	22	1918	124, 926, 347	1, 032, 337	652	162, 615	10, 989, 720	12, 185, 324	8. 5		1. 3	2, 284, 642	20. 8	277, 241, 490	4. 0
Do	12	1919	67, 299, 302	304, 518			6, 372, 524	6, 677, 042	4. 6			3, 012, 520	47. 3	11, 089, 093	57. 5
Do	10	1920	53, 301, 006	274, 425			4, 117, 744	4, 392, 169	6. 2			1, 240, 872	30. 1	7, 759 732	53. 1
Total			245, 527, 345	1. 611, 280	652	162, 615	21, 479, 988	23, 254, 535	6. 9		. 7	6, 538, 034	30. 4	296, 090, 315	7. 3
Iron mining	22	1918	107, 210, 496	2, 501, 089	992, 950	3, 538, 619	17, 311, 768	24, 344, 426	10. 3	4. 1	14. 5	6, 352, 877	36. 7	93, 708, 651	18. 5
Do	13	1919	17, 401, 771	891, 739		688, 097	1, 972, 276	3, 352, 112	20. 6		20. 5	225, 621	11. 4	13, 273, 612	14. 9
Do	7	1920	59, 784, 426	1, 684, 716		1, 109, 806	9, 846, 299	12, 640, 821	13. 3		8. 8	659, 976	6. 7	74, 721, 091	13. 2
Total			184, 396, 695	4, 877, 544	992, 950	5, 336, 522	29, 130, 343	40, 337, 359	12. 1	2. 5	13. 2	7, 238, 474	24. 8	181, 703, 354	16. 0
Iron and steel	63	1918	3, 013, 183, 740	57, 163, 441	74, 224, 800	16, 704, 515	575, 423, 276	723, 516, 032	7. 9	10. 3	2. 3	288, 863, 201	50. 2	2, 136, 487, 131	26. 9
Do	62	1919	673, 260, 417	22, 242, 712	8, 920, 219	1, 621, 791	73, 913, 091	106, 697, 813	20. 8	8. 4	1. 5	4, 960, 708	6. 6	763, 271, 077	12. 3
Do	21	1920	212, 762, 985	7, 111, 603		475, 218	18, 915, 134	26, 501, 955	26. 8		1. 8	1, 026, 821	5. 4	210, 834, 222	9. 0
Total			3, 899, 207, 142	86, 517, 756	83, 145, 019	18, 801, 524	668, 251, 501	856, 715, 600	10. 1	9. 7	2. 2	294, 752, 730	44. 1	3, 110, 592, 430	21. 5
Iron and steel (structural)	62	1918	98, 467, 326	2, 220, 863	242, 025	19, 887	13, 495, 178	15, 977, 953	13. 9	1. 5	. 1	6, 482, 062	48. 0	48, 569, 274	27. 8
Do	35	1919	52, 163, 606	1, 251, 680	231, 476	6, 660	8, 662, 750	10, 152, 566	12. 3	2. 3	. 1	3, 063, 597	35. 4	33, 362, 848	26. 0
Do	22	1920	28, 694, 027	356, 228	192, 498	3, 187	2, 160, 574	2, 712, 487	13. 1	7. 1	. 1	409, 099	18. 9	12, 381, 842	17. 4
Total			179, 324, 959	3, 828, 771	665, 999	29, 734	24, 318, 502	28, 843, 006	13. 3	2. 3	. 1	9, 954, 758	40. 9	94, 313, 964	25. 8
Meat packers	96	1918	3, 483, 912, 702	12, 417, 635	651, 553	705, 987	72, 554, 848	86, 330, 023	14. 4	. 8	. 8	9, 230, 786	12. 7	525, 960, 755	13. 8
Do	62	1919	1, 388, 037, 495	5, 979, 114		11, 624	10, 811, 583	16, 802, 321	35. 6		. 1	572, 071	5. 3	245, 644, 670	4. 4
Do	34	1920	145, 034, 519	670, 504			3, 079, 225	3, 749, 729	17. 9			409, 965	13. 3	18, 532, 138	16. 6
Total			5, 016, 984, 716	19, 067, 253	651, 553	717, 611	86, 445, 656	106, 882, 073	17. 8	. 6	. 7	10, 212, 822	11. 8	790, 137, 563	10. 9

Summary of statistical data from special assessment section—Representative companies used as comparatives—Continued

Industry	Number of companies	Year	Gross income	Depreciation	Amortization	Depletion	Net income	Net operating income	Per cent depreciation to net operating income	Per cent amortization to net operating income	Per cent depletion to net operating income	Profits tax	Per cent profits tax to net income	Invested capital	Per cent net income to invested capital
Motion picture	7	1918	$29,982,471	$192,624	$14,339		$2,207,348	$2,414,361	8.0	0.6		$702,796	31.8	$14,140,743	15.6
Do	10	1919	64,579,095	360,870		$14,389	4,571,708	4,946,967	7.3		0.3	861,890	18.9	27,736,561	16.5
Do	7	1920	71,405,539	1,443,086			8,760,118	10,203,204	14.1			1,459,279	16.7	40,139,838	21.8
Total			165,967,105	1,996,580	14,389	14,389	15,539,174	17,564,532	11.4	.1	.1	3,023,965	19.5	82,017,142	18.9
Newspaper publishing	45	1918	116,318,627	1,705,778	1,303		9,268,054	10,975,135	15.5	.01		1,879,089	20.3	65,287,731	14.2
Do	55	1919	164,651,670	2,278,428	2,712	26,517	18,825,222	21,132,879	10.8	.01	.1	3,481,203	18.5	72,743,061	25.9
Do	43	1920	79,983,488	983,728		19,929	11,776,411	12,780,068	7.7		.2	2,938,114	24.9	33,005,287	35.7
Total			360,953,785	4,967,934	4,015	46,446	39,869,687	44,888,082	11.1	.01	.1	8,298,406	20.8	171,036,079	23.3
Oil production	102	1918	284,955,245	12,424,083	387,931	18,188,848	58,664,081	89,664,943	13.9	.4	20.3	15,537,174	26.5	300,871,056	19.5
Do	115	1919	338,315,023	11,968,261	440,341	18,730,451	47,480,067	78,619,120	15.2	.5	23.8	6,906,768	14.5	264,526,689	17.9
Do	80	1920	380,027,720	8,819,102		16,381,431	45,608,339	70,808,872	12.5		23.1	7,522,636	16.5	206,230,963	22.1
Total			1,003,297,988	33,211,446	828,272	53,300,730	151,752,487	239,092,935	13.9	.3	22.3	29,966,578	19.7	771,628,708	19.7
Oil producing and refining	30	1918	779,228,392	31,500,634	5,654,906	44,349,566	128,722,317	210,227,423	15.0	2.7	21.1	46,047,619	35.8	635,360,044	20.3
Do	19	1919	1,082,551,922	41,114,921	35,189,011	32,177,902	126,887,843	235,369,677	17.5	15.0	13.7	12,092,235	9.5	864,356,913	14.7
Do	12	1920	1,379,800,491	36,998,166	17,623,699	37,353,309	184,585,274	276,560,448	13.4	6.4	13.5	22,852,237	12.4	947,955,254	19.5
Total			3,241,580,805	109,613,721	58,467,616	113,880,777	440,195,434	722,157,548	15.2	8.1	15.8	80,992,091	18.4	2,447,666,211	18.0
Producing natural gas	20	1918	22,059,605	2,816,505		3,817,516	5,776,507	11,780,528	23.9		27.1	1,613,881	27.9	38,029,522	15.2
Do	10	1919	6,144,126	416,399		421,067	1,152,209	1,989,675	20.9		21.2	128,079	11.1	7,427,680	15.5
Do	5	1920	2,340,019	489,567		26,129	746,305	1,262,001	38.8		2.1	109,297	14.6	3,521,245	21.2
Total			30,543,750	3,722,471		3,634,712	7,675,021	15,032,204	24.8		24.2	1,851,257	24.1	48,978,447	15.7

Oil refining	60	1918	329, 407, 840	8, 439, 143	3, 510, 587	3, 850, 727	43, 239, 427	59, 048, 884	14. 3	5. 9	6. 5	19, 439, 786	45. 0	165, 119, 366	26. 2
Do	33	1919	38, 866, 659	1, 072, 483	205, 933	101, 727	3, 031, 883	4, 412, 026	24. 3	4. 7	2. 3	509, 400	16. 8	16, 566, 553	18. 3
Do	19	1920	25, 437, 301	396, 470		11, 460	2, 395, 241	2, 803, 171	14. 1		. 4	709, 459	29. 6	4, 850, 521	49. 4
Total			393, 711, 800	9, 908, 096	3, 716, 520	3, 972, 914	48, 666, 55[illegible]	66, 264, 081	15. 0	5. 6	6. 0	20, 658, 645	42. 4	186, 536, 440	26. 1
Patents and royalties	53	1918	14, 278, 908	487, 787	15, 133	1, 779, 340	3, 387, 645	5, 669, 905	8. 6	. 3	31. 4	934, 769	27. 6	22, 321, 161	15. 2
Do	45	1919	21, 509, 853	723, 571	60, 787	5, 330, 568	5, 695, 683	11, 810, 609	6. 1	. 5	45. 1	1, 017, 765	17. 9	28, 340, 785	20. 1
Do	34	1920	42, 573, 302	982, 369	36, 032	1, 506, 302	5, 514, 872	8, 039, 575	12. 2	. 4	18. 7	899, 222	16. 3	39, 013, 328	14. 1
Total			78, 362, 063	2, 193, 727	111, 952	8, 616, 210	14, 598, 200	25, 520, 989	8. 6	. 4	33. 8	2, 851, 756	19. 5	89, 675, 274	16. 3
Railway companies	13	1918	3, 327, 934	117, 986			1, 068, 972	1, 186, 858	9. 9			195, 187	18. 3	6, 916, 924	15. 7
Do	13	1919	9, 358, 631	222, 121	3, 024		3, 116, 235	3, 341, 380	6. 6	. 1		631, 932	20. 3	27, 647, 234	11. 3
Do	3	1920	969, 486	32, 173			309, 497	341, 670	9. 4			24, 029	7. 8	2, 317, 719	13. 4
Total			13, 656, 051	372, 280	3, 024		4, 494, 704	4, 870, 008	7. 6	. 1		851, 158	18. 9	36, 881, 877	12. 2
Salt manufacturing	16	1918	17, 560, 914	798, 277	74, 170	190, 227	4, 330, 226	5, 392, 900	14. 8	1. 4	3. 5	1, 177, 009	27. 2	16, 000, 033	27. 1
Do	15	1919	21, 700, 058	538, 746		73, 817	2, 549, 098	3, 161, 661	17. 0		2. 3	363, 839	14. 3	13, 244, 563	19. 2
Do	7	1920	11, 903, 974	414, 593		53, 273	1, 987, 997	2, 455, 863	16. 9		2. 2	355, 949	17. 9	8, 406, 111	23. 6
Total			51, 164, 946	1, 751, 616	74, 170	317, 317	8, 867, 321	11, 010, 424	15. 9	. 7	2. 9	1, 896, 797	[illegible]	37, 650, 707	23. 6
Sand and gravel	29	1918	8, 080, 051	467, 396	45, 545	73, 958	1, 736, 143	2, 323, 042	20. 1	2. 0	3. 2	710, 728	40. 9	7, 144, 347	24. 3
Do	32	1919	9, 398, 978	620, 085	2, 671	125, 228	1, 560, 885	2, 308, 869	26. 9	. 1	5. 4	192, 813	12. 4	9, 169, 114	17. 0
Do	30	1920	8, 177, 370	433, 322	419	161, 280	1, 465, 603	2, 060, 624	21. 0	. 02	7. 8	235, 549	16. 1	6, 370, 844	23. 0
Total			25, 656, 399	1, 520, 803	48, 635	360, 466	4, 762, 631	6, 692, 535	22. 7	. 7	5. 4	1, 139, 090	23. 9	22, 684, 305	21. 0
Sheet metal	60	1918	124, 473, 169	3, 413, 516	723, 834	40, 023	11, 318, 097	15, 495, 470	22. 0	4. 7	. 3	4, 316, 773	31. 8	56, 292, 688	20. 1
Do	53	1919	41, 407, 227	643, 867	70	85, 042	4, 369, 748	5, 098, 727	12. 6		1. 7	614, 548	14. 1	25, 474, 349	17. 2
Do	30	1920	23, 547, 586	474, 348	2, 310	1, 714	2, 437, 875	2, 916, 247	16. 3	. 1	. 1	417, 178	17. 1	11, 644, 352	20. 9
Total			189, 427, 982	4, 531, 731	726, 214	126, 779	18, 125, 720	23, 510, 444	19. 3	3. 1	. 5	5, 348, 499	29. 5	93, 411, 369	19. 4
Shipbuilding	25	1918	250, 671, 101	2, 184, 078	4, 244, 908	132, 544	35, 053, 143	41, 614, 673	5. 2	10. 2	. 3	23, 758, 373	67. 8	66, 165, 924	53. 0
Do	14	1919	302, 031, 036	3, 399, 805	2, 580, 447	532, 095	39, 752, 839	46, 265, 186	7. 3	[illegible]	1. 2	16, 270, 536	46. 9	87, 567, 778	45. 4
Do	17	1920	170, 064, 927	2, 615, 814	3, 659, 999	57, 447	20, 890, 302	27, 223, 562	9. 6	13. 4	. 2	4, 462, 426	21. 4	99, 682, 353	21. 0
Total			722, 767, 064	8, 199, 697	10, 485, 354	722, 086	95, 696, 284	115, 103, 421	7. 1	9. 1	. 6	44, 491, 335	46. 5	253, 416, 055	37. 8
Shoe manufacturing	25	1918	115, 775, 615	926, 614			6, 546, 298	7, 472, 912	12. 4			1, 577, 860	24. 1	39, 763, 796	16. 5
Do	25	1919	190, 059, 894	1, 017, 974			16, 785, 570	17, 803, 544	5. 7			3, 828, 903	22. 8	57, 056, 938	29. 4
Do	9	1920	55, 272, 034	207, 969			4, 043, 923	4, 251, 892	4. 9			702, 743	17. 4	20, 793, 677	19. 4
Total			361, 107, 543	2, 152, 557			27, 375, 791	29, 528, 348	7. 3			6, 109, 512	22. 3	117, 614, 411	23. 3

Summary of statistical data from special assessment section—Representative companies used as comparatives—Continued

Industry	Number of companies	Year	Gross income	Depreciation	Amortization	Depletion	Net income	Net operating income	Per cent depreciation to net operating income	Per cent amortization to net operating income	Per cent depletion to net operating income	Profits tax	Per cent profits tax to net income	Invested capital	Per cent net income to invested capital
Steamship companies	56	1918	$65,102,174	$4,387,614	$1,531,510	$42,596	$32,202,196	$38,163,916	11.5	4.0	0.1	$17,886,366	55.5	$91,761,002	35.1
Do	50	1919	103,460,905	5,215,572	2,257,260		54,053,044	61,525,876	8.5	3.7		13,439,082	24.9	153,704,858	35.2
Do	31	1920	22,934,530	961,565			5,140,245	6,101,810	15.8			760,095	14.8	27,752,433	18.5
Total			191,497,609	10,564,751	3,788,770	42,596	91,395,485	105,791,602	10.0	3.6	.04	32,085,543	35.1	273,218,293	33.5
Street railways	10	1918	5,460,799	166,620	6,000		2,856,284	3,028,904	5.5	.2		199,933	7.0	61,172,808	4.7
Do	7	1919	36,321,840	2,013,569	154,689		3,836,588	6,004,846	33.5	2.6		53,771	1.4	60,236,082	6.4
Do	7	1920	3,197,462	312,547	9,464		411,394	733,405	42.6	1.3		30,396	7.4	3,148,391	13.1
Total			44,980,101	2,492,736	170,153		7,104,266	9,767,155	25.5	1.7		284,100	4.0	124,557,281	5.7
Taxicab companies	16	1918	8,604,443	671,327			521,526	1,192,853	56.3			91,272	17.5	3,778,289	13.8
Do	11	1919	3,342,315	325,334			215,712	541,046	60.1			27,834	12.9	944,734	22.8
Do	22	1920	6,076,195	511,380			358,231	869,611	58.8			35,750	10.0	2,021,360	17.7
Total			18,022,953	1,508,041			1,095,469	2,603,510	57.9			154,856	14.1	6,744,383	16.2
Tobacco	75	1918	556,302,742	2,166,472			62,124,874	64,291,346	3.4			13,877,280	22.3	379,507,926	16.4
Do	49	1919	64,491,923	243,493			4,925,270	5,168,763	4.7			844,321	17.1	22,530,386	21.9
Do	22	1920	30,472,390	115,358			2,069,368	2,184,726	5.3			355,581	17.2	8,358,992	24.8
Total			651,267,055	2,525,323			69,119,512	71,644,835	3.5			15,077,182	21.8	410,395,304	16.8
Woolen manufacturing	18	1918	298,125,370	3,619,511	47,210		53,908,956	57,575,677	6.3	.1		24,658,401	45.7	132,004,802	40.8
Do	16	1919	175,677,623	4,686,555			25,096,227	29,782,782	15.7			3,716,268	14.8	129,866,232	19.3
Do	14	1920	14,324,609	211,504			1,560,286	1,771,790	11.9			295,820	19.0	6,359,544	24.5
Total			488,128,602	8,517,570	47,210		80,565,469	89,130,249	9.6	.1		28,670,509	35.6	268,230,878	30.0

Exhibit F

Overassessments due to special assessment

[Section 210 of 1917 act; section 328 of 1918 act]

Name and address of taxpayer	Sections	Total refunds, credits, and abatements
W. Beckers Aniline & Chemical Works (Inc.), New York, N. Y	210	$440,625.19
Schoellkopf Aniline & Chemical Works (Inc.), Buffalo, N. Y	210	1,829,141.16
Jos. Joseph & Bros., Cincinnati, Ohio	210	348,757.02
T. A. Gillespie Co., 7 Dey Street, New York, N. Y	328	600,629.74
Runyon Corporation, 7 Dey Street, New York, N. Y	328	526,091.69
International Shell & Ordnance Co., New York, N. Y	328	1,819,009.54
International Loading Co., 7 Dey Street, New York, N. Y	328	1,010,919.33
American Shell Co., 7 Dey Street, New York, N. Y	328	1,943,170.25
Fickands Brown & Co., Chicago, Ill	328	450,256.39
Coca Cola Co., Plum Street and North Avenue, Atlanta, Ga	210	316,453.36
Rockford Mitten & Hosiery Co., Rockford, Ill	328	279,713.97
Maas & Waldstein Co., 92 William Street, New York, N. Y	210	462,038.34
J. F. Duthie & Co., Seattle, Wash	328	330,385.15
Atlas Crucible Steel Co., Dunkirk, N. Y	328	788,334.88
R. J. Reynolds Tobacco Co., Winston-Salem, N. C	328	1,698,285.47
Four Wheel Drive Auto Co., Clintonville, Wis	210	348,931.60
Theta Oil Co., 76 West Monroe Street, Chicago, Ill	328	427,615.57
Hecla Mining Co., Wallace, Idaho	210	492,915.80
Allegheny Steel Co., Pittsburgh, Pa	328	556,553.59
United States Branch of Employers Liability Assurance Corporation, Boston, Mass	328	325,270.72
H. W. Johns-Manville Co., Madison Avenue and Forty-first Street, New York	328	519,000.87
Neuss Hesslein & Co., New York, N. Y	210	421,378.13
Fulton Bag & Cotton Mills, Atlanta, Ga	210	352,506.86
Fellows Medical Manufacturing Co., New York, N. Y	210	280,446.88
Bessemer Coal & Coke Co., Pittsburgh, Pa	210	261,153.57
Centaur Co., 250 Broadway, New York, N. Y	328	368,063.26
Whitaker-Glessner Co., Wheeling, W. Va	210	353,033.07
Four Wheel Drive Auto Co., Clintonville, Wis	328	241,334.31
Globe & Rutgers Fire Insurance Co., New York, N. Y	210	450,011.32
Atolia Mining Co., San Francisco, Calif	210	256,018.46
Latrobe Electric Steel Co., Latrobe, Pa	328	426,047.32
Curtis & Co. Manufacturing Co., St. Louis, Mo	328	278,236.38
E. J. Lavine & Co., Philadelphia, Pa	210	521,825.00
American Car & Foundry Co., 165 Broadway, New York, N. Y	328	5,209,204.74
Cleveland & Western Coal Co., Cleveland, Ohio	210	457,324.44
Lindsay Light Co., 116 East Grand Avenue, Chicago, Ill. (fiscal year)	210 328	316,890.33
Youngstown Sheet & Tube Co., Youngstown, Ohio	210	3,482,610.51
Northwest Steel Co., Portland, Oreg	210	923,235.81
Select Pictures Corporation, New York, N. Y	328	384,475.17
Carbon Steel Co., foot Thirty-second Street, Pittsburgh, Pa	328	559,039.14
New Jersey Worsted Spinning Co., Garfield, N. J. (fiscal year)	210 328	401,577.98
Otis Steel Co., 1140 Leader News Building, Cleveland, Ohio	210	398,629.35
Jobbers Overall Co., Lynchburg, Va	328	331,981.62
J. B. Inderrieden Co., 332 River Street, Chicago, Ill	328	265,373.04
Bartlett-Hayward Corporation, Baltimore, Md	328	1,443,735.21
Gans Steamship Lines, 12 Broadway, New York, N. Y	328	508,285.10
West Virginia Coal Co. of Missouri, St. Louis, Mo	328	402,458.00
Whitney Blake Co., New Haven, Conn	328	337,332.02
Electric Storage Battery Co., care J. M. Haynes, attorney, Investment Building, Washington, D. C	328	640,188.12
Kokomo Steel & Wire Co., Kokomo, Ind	210	282,426.05
W. and A. Fletcher Co., Hoboken, N. J	328	388,526.84
J. C. Penney Co., 354 Fourth Avenue, New York, N. Y	210	469,246.88
Pittsburgh Steel Products Co., Pittsburgh, Pa	328	1,830,227.55
Total		38,768,702.09

Treasury Department,
Washington, November 17, 1925.

Hon. James Couzens,
Chairman Senate Committee Investigating the Bureau of Internal Revenue, United States Senate.

My Dear Senator: With further reference to your letter of September 24, 1925, I am attaching a memorandum in reply to the criticism of your committee on the special-assessment section of the Income Tax Unit.

Sincerely yours,

C. R. Nash,
Assistant to the Commissioner.

NOVEMBER 17, 1925.

Mr. C. R. NASH,
Assistant to the Commissioner.

Under date of August 13, 1925, Mr. L. H. Parker, chief engineer, submitted a report to Mr. L. C. Manson, general counsel of the Senate committee investigating the Income Tax Unit of the Bureau of Internal Revenue, covering his investigation of the administration by the Bureau of Internal Revenue of the special-assessment provisions of the revenue acts of 1917, 1918, and 1921. A copy of this report has been furnished the bureau.

Mr. Parker reports that it appears—

I. That the application of section 210 of the act of 1917 is sound where the invested capital of the taxpayer could not be satisfactorily determined.

II. That the bureau has exceeded its authority in making retroactive the provisions of sections 327 and 328 of the 1918 act in regard to abnormalities in invested capital and income to apply to the year 1917.

III. That the whole method of special assessment granted to companies under section 327 of the act of 1918 on the basis of abnormalities in invested capital and income is unsound.

IV. That the administration of these sections by the bureau has caused "a frightful discrimination between business concerns and industries of the country."

I. The first comment of the investigator needs no reply, inasmuch as he has reached the conclusion that the bureau's practice relative thereto is sound.

II. With reference to the second conclusion, to the effect that the bureau has exceeded its authority in making retroactive the provisions of sections 327 and 328 of the revenue act of 1918 in regard to abnormalities in invested capital and income to apply to the year 1917, it is interesting to note that this is not exactly a correct statement of the facts. It would be more exact to state that the practices adopted by the bureau in administering the provisions of section 210 of the revenue act of 1917 were projected into and became sections 327 and 328 of the revenue act of 1918.

Confronted with the vague language of section 210, the department was forced to adopt, under authority of section 1005, certain rules and regulations to the end that the so-called "special assessment provision" of the revenue act of 1917 could be applied with as near equality as possible to all taxpayers coming within its provisions. When sections 327 and 328 were being written, the legislators, who must be presumed to have been familiar with the practices of the departments worked out in administering section 210, attempted to embody in the relief provision, of the revenue act of 1918, in so far as general language would permit, the practices which had been worked out by the department up to that time in administering the provisions of section 210, with which the department had then been wrestling almost a year. This is indicated by the following very significant statement made by Senator Simmons, one of the conferees, in reporting the bill to the Senate:

"The House bill, notwithstanding the great increase in the rates of the profits tax, did not embody a number of these protective provisions. Without attempting to go into detail, I can assure the Senate that all of the protective and relief provisions worked out by the department from its actual practice have now been embodied in the bill. These relief provisions, far more necessary than before the adoption of the higher rates, will, I am sure, continue to prevent injustice as between different taxpayers and will temper the apparent severity of the letter of the law."

The department has therefore deemed it proper that where profits' tax is to be computed under the provisions of section 210 of the revenue act of 1917 to compare the taxpayer with representative concerns engaged in a like or similar trade or business and similarly circumstanced in so far as possible in all material factors, and has so construed the meaning of the word "representative" appearing in that section. Articles 18, 24, and 52 of regulations 41 so provide, and the department believes that under authority of section 1005 of the revenue act of 1917 the commissioner, with the approval of the Secretary, had authority to make such regulations. These regulations recognize that corporations having abnormalities in either income or capital are entitled to the consideration provided by section 210 and to relief thereunder if comparison with representative concerns so discloses.

III. The engineer's third comment is that the whole method of special assessment adopted by the department is unsound. He then states:

"It must be kept clearly in mind that one of the basic principles of the act is the fixing of the tax according to the taxpayer's ability to pay, and while any tax may be a hardship, it can be construed only as an exceptional hardship, in view of the general principles governing the whole revenue act, when the taxpayer would be so affected that he is seriously prejudiced in maintaining his business and competing with his rivals in the same industry, or when it comes to the point where he is really unable to pay."

Some difficulty has been experienced in grasping the thought above expressed. Let us assume an example:

A taxpayer made an extremely large profit in 1918, and, through inexperience or ignorance, filed an erroneous return, deducting some unallowable deductions and including in invested capital items specifically excluded by the act, or not properly includable therein. In a later year the bureau audits the return and finds, say, $100,000 additional tax due for 1918. In the meantime, however, the taxpayer has suffered serious financial difficulties and at the time of the bureau's final audit finds itself in such a condition financially that it would be "seriously prejudiced" if required to pay the tax. In such a case does the examining engineer intend to say that the tax legally found to be due should be recomputed on the basis of "the taxpayer's ability to pay"? If so, then the bureau must vigorously assert that it does not believe that this is "one of the basic principles of the act." The commissioner is required by law to assess any tax legally found to be due.

The report criticizes rather severely the practice of the bureau in conceding abnormalities in income and capital arising from—

(1) Insufficient salaries paid to officers.

(2) Sale of capital assets within the taxable year.

(3) Personal service element in the business.

The examiner concedes that a taxpayer would be entitled to consideration under the special assessment provisions of the law because of abnormalities arising from—

(1) Substantial intangible value in a business of small capitalization.

(2) A corporation operating with a large amount of borrowed capital.

(3) Where respective values of mixed aggregates of tangible and intangible properties paid in for stocks and bonds can not be satisfactorily determined.

The basis of the criticism of the bureau's policy of recognizing an abnormality in income arising from the payment of inadequate salaries rests on certain computations of income and tax in a hypothetical case through which the conclusion is reached that where a corporation pays abnormally small salaries to its officers, not only the corporation but the Government profits thereby, as a result of which no hardship would be imposed upon the corporation. The bureau's practice of recognizing such an abnormality is then condemned.

To test the soundness of the arguments advanced, let us assume a hypothetical case:

Corporations A and B are engaged in the same business and are competitors. Officers' salaries in this field of industry average approximately 2½ per cent of gross sales, and corporation B pays that amount. Its competitor, corporation A, however, is a closed corporation owned by one man and his immediate family, as a result of which only nominal salaries are paid to its officers. A comparison of the two concerns might appear thus:

	Company A	Company B
Invested capital	$5,000,000	$5,000,000
Gross sales	20,000,000	20,000,000
Cost of goods sold and other deductions except officers' salaries	19,000,000	19,000,000
Officers' salaries	36,000	500,000
Net income	964,000	500,000
Profits tax	368,800	29,100
Per cent profits tax to net income	+38.25	5.82

Here we would have two concerns exactly alike in all particulars except as to the deduction claimed for officers' salaries. This one abnormality in company A causes it to pay profits taxes in the amount of $368,800 as against $29,100 paid by its competitor, which deducted normal salaries. The bureau would hold that this condition was abnormal and justified consideration under the relief provisions of the law. The fallacy of the engineer's computations lies in the fact that he uses "a composite tax rate of 55 per cent." There could be no such rate except by comparison with other concerns, and in the illustration shown above this rate would be about 6 per cent instead of the 38.25 per cent without the benefit of special assessment. The effect of the income and tax on the individuals is of no moment. The question to be decided is whether the corporation is suffering a hardship of inequality in tax because of its failure to pay normal salaries to its officers.

The bureau agrees with the examining engineer's statement that the general intent of the statute was to tax as income appreciation of capital assets realized on sale and that there is no reason for interpreting the meaning of section 327 in such a manner as to make this provision of the statute null and void. The realization through sale of appreciation of assets the value of which has accrued merely through the affluxion of time, surrounding industrial development or some similar cause, creates no abnormality in income in the year of sale, but such realization on the sale of a capital asset the value of which has been built up through years of unproductive effort does create an abnormality in income in the year of sale. The following example will illustrate the point:

Two banks are engaged in business in the same town as competitors. On March 1, 1913, each had a capitalization of $100,000, representing tangible assets acquired for capital stock of that amount. The prior earnings of neither bank demonstrated good will or going business value on March 1, 1913. Subsequent to that date one bank, through possibly a change in management, increased its business so that by 1918 the earnings of that bank justified a going business value of, say, $50,000 The other bank developed no such intangible assets. In December, 1918, the first bank had a market value of $150,000, represented by tangible assets of $100,000, and developed good will or going business value of $50,000. The other bank had a market value of only $100,000, represented by its tangible assets. Both banks were sold in December, 1918, for their fair market value, $150,000 and $100,000, respectively. Profit on the sale of the first bank was, of course, the difference between the sales price and the March 1, 1913, value, or $50,000. The second bank received no profit on sale. Let us assume that each bank earned during 1918, 10 per cent on its capital. Bank A would therefore have earned $15,000 and bank B $10,000. Bank A, however, had losses of $5,000, so that the net income for the banking business of each concern was $10,000, but bank A, through the sale of a capital asset built up over a period of years, had a net income of $10,000 plus the $50,000 profit on sale, or a taxable net income of $60,000. The bureau would consider such a condition as creating an abnormality in the income of the first bank justifying special assessment. A comparison of the two banks, showing the computation of the tax, is as follows:

	Bank A	Bank B
Tangible assets Mar. 1, 1913, represented by capital stock	$100,000	$100,000
Good will, deposit accounts, or going-business value Mar. 1, 1913	0	0
Same, intangible assets built up from Mar. 1, 1913, to December, 1918	50,000	0
Invested capital, 1918 (assuming no change)	125,000	100,000
Value of business December, 1918	150,000	100,000
Sold in December, 1918, for	150,000	100,000
Profit on sale	50,000	0
Income for regular banking business before losses (10 per cent on capital)	15,000	10,000
Losses	5,000	0
Net income from banking business	10,000	10,000
Taxable net income for 1918	60,000	10,000
Profits tax	35,600	0
Percentage of profits tax to net income	59.33	....

Manifestly, it would be unfair to assess a profits tax of 59.33 per cent against bank A when five-sixths of its net income was derived from the sale of an asset which had been built up by the efforts of the officers over a period of years. The income of bank A is thus abnormally inflated and that bank would be entitled to special assessment.

In certain cases the bureau has recognized the personal service element as creating an abnormality justifying special assessment. The engineer's criticism of this practice is very brief and is as follows:

"There are several other grounds for granting special assessment, one of which is based on the extraordinary value of the personal sevices rendered by the officers of the company. This ground is too ridiculous to argue, for it is evident that efficient management of a corporation should not be considered an abnormal condition or one demanding relief from taxation."

The examiner seems to have missed the point. The bureau has consistently held that efficient management of a business is no ground for special assessment. Where, however, a concern, which except for some technicality of the law would otherwise be classed as a personal service corporation, is denied personal service, then a situation might arise justifying special assessment. The following example will illustrate the point:

Two concerns, competitors, derive their income wholly from commissions in 1918. Company A complies with all of the requirements of section 200 of the revenue act of 1918—that is, it qualifies as a corporation whose income is ascribed primarily to the activities of the principal owners or stockholders who are themselves regularly engaged in the active conduct of the affairs of the corporation, and in which capital (whether invested or borrowed) is not a material income-producing factor. Company B, however, is denied personal service classification because a 40 per cent stockholder in this company is not actively engaged in producing the income. A comparison of the two companies would be shown thus:

	Company A	Company B
Invested capital (represented by office furniture)	$1,000	$1,000
Net income	150,000	150,000
Profits tax	(1)	[2] 109,100
Percentage of profits tax to net income		72.73

[1] None payable. [2] Under sec. 302.

It is apparent that if special assessment were denied to Company B that company would be very severely penalized solely because of a technicality of the law. The relief provisions were inserted to remedy such a situation.

It is noted that the engineer concedes the soundness of the bureau's practice in granting special assessment in certain cases on the ground that there is substantial intangible value in a business of small capitalization which can not be recognized in statutory invested capital. He states, however, that when special assessment is granted on this ground the constructed invested capital should not be increased beyond the 25 per cent limitation provided for in the revenue act of 1918. The bureau concurs in this opinion and does not approve any relief beyond that to which a taxpayer normally situated would be entitled.

The legislative history of the relief provisions of the revenue act of 1918 clearly shows that it was the intent of Congress to grant relief in those cases where, owing to some abnormal condition in income or capital, a taxpayer would suffer a hardship of inequality as compared with other concerns similarly circumstanced but normally situated, and it was left within the discretion of the commissioner to determine when an exceptional hardship was being worked upon a taxpayer. When the bill first passed the Senate, section 327 provided that the tax should be determined as provided in section 328 in nine enumerated classes of cases. This number was materially in excess of the classes of cases carried in the section as it passed the House. The House and Senate conferees, realizing the impossibility of specifically providing for all cases that might be entitled to special assessment, reduced the specified cases to three and then made a general class to cover all others, thus placing upon the commissioner the responsibility of finding and declaring of record that the tax in any specific case, if determined without the benefit of the section, would, owing to abnormal conditions affecting capital or income, work an exceptional hardship. The reason for this was thus stated by Mr. Kitchin in a speech before the House in explanation of the changes made in conference:

"Under the specific provisions no official had any particular responsibility, and one could take any case he desired, whether there was an exceptional hardship or not, and make application that the tax should be computed on the basis of representative corporations."

Senator Penrose, in a speech delivered Wednesday, February 12, 1919, after the meeting of the Senate and House conferees, stated with reference to the amendment of section 327 made in conference:

"This amendment, to my mind, is a most admirable one. The Senate greatly increased the classes of cases entitled to this relief. The conferees amalgamated all of these classes into a single general class, but denied the relief to corporations whose principal income consists of profits derived on a cost-plus basis on war contracts."

The plan evidently was to give the commissioner the power to administer the excess profits tax law with as few inequalities as possible to taxpayers falling in the same class. If, due to abnormal conditions, an exceptional hardship of inequality appears to have been imposed upon any taxpayer by computing its invested capital under section 326, such taxpayer has the right to appeal to the commissioner and show that because of such abnormality it is having to pay a higher rate of tax than other corporations which are similarly circumstanced, and to ask that it be allowed to pay a tax equal to the average rate of tax paid by other corporations which are in its class similarly circumstanced and operating under normal conditions. However, when it has shown the inequality or disproportion in the tax, before it is entitled to the relief sought it must go further and show that the inequality is due not merely to large profits earned upon a normal capital but to abnormal conditions affecting its income or capital.

The thought in the minds of those in charge of the bill was centered upon preventing inequalities and unjust discriminations. If a corporation's tax is high merely because it made large profits upon a normal invested capital, no relief is to be granted. If, however, owing to some abnormal condition affecting its income or capital it is compelled to pay a higher rate of tax than other corporations in its class, then it may show it is under a hardship of inequality and gain relief under sections 327 and 328. The power placed in the hands of the commissioner is, first, to determine whether an abnormal condition affecting capital or income exists, and, if it does and if by comparison with other concerns it results in a hardship of inequality in tax, he is to average the taxpayer's tax with comparatives selected according to the act.

LESLIE GILLIS,
Acting Chief Special Assessment Section.

[Star Co. (newspaper)

By Geo. G. Box, July 13, 1925

William R. Hearst owns all stock; borrowed money included in invested capital]

JULY 13, 1925.

In re: Star Co., New York City

This taxpayer is a publisher of newspapers and was the principal corporation of a group of approximately 30 affiliated corporations for the years from 1917 to 1919. It was considered by the Income Tax Unit as a class B affiliation, William R. Hearst owning 100 per cent of the capital stock of the majority of the corporations, while in the other instances the smaller corporations were subsidiaries of the others.

The original taxes paid by the taxpayer, the additional assessments proposed by A-2 letters of the Income Tax Unit, and the actual additional assessments made as a result of adjustments determined after consideration of briefs filed by the taxpayer are as follows:

Year	Original tax paid	Proposed additional assessments A-2 letters	Amounts finally determined upon
1917	$65,387.53	$604,610.28	$94,823.18
1918	161,079.55	850,520.40	21,585.03
1919	298,644.38	576,305.94	177,931.11
Total	525,111.46	2,031,436.62	294,339.32

Proposed additional assessments	$2,031,436.62
Amount of final determination by bureau	294,339.32
Tax liability reduced by bureau conferences	1,737,097.30

Among the disputed items which were originally disallowed by the Income Tax Unit prior to the mailing of the A-2 letters and which were subsequently allowed by the conferees are the following:

1. *Deduction of $203,964.36 from gross income of taxpayer, which it claimed as a loss upon the liquidation of the German Journal.*—The German Journal Corporation was owned 100 per cent by the Star Co. from 1904. Advances were made to it by the latter from time to time, and on January 1, 1918, these advances aggregated $203,964.36. During 1918 the Journal ceased to operate and was liquidated by the taxpayer, as a result of which the latter claims the loss as a deduction from income for that year. This loss is purely intercompany and therefore not deductible in determining consolidated net income, as the consolidated surplus is not affected by such liquidation.

The following referred-to decisions are in support of the disallowance of this deduction:

(A. R. R. 2455.) In this case an account was owed to one subsidiary. In the liquidation of the debtor subsidiary the account receivable was a loss. The committee on appeals and review held that such loss was an intercompnay transaction and no deduction was allowable from gross income for taxation purposes on account of the transaction.

(A. R. R. 6066.) In this case it was held by the committee on appeals and review that an account receivable in the liquidation of a subsidiary was an intercompany transaction and should be eliminated in arriving at the net income of the consolidated group.

(Solicitor's recommendation No. 4500.) In this case Campbell-Morrell & Co. own 100 per cent of the stock of the Citizens' Coal & Supply Co. The parent company had advanced to its subsidiary $27,453.16, which appeared on its records as an account receivable. Upon dissolution of the latter, the parent company received in liquidation $2,153.94, thereby reflecting a loss from its advances and investment of $10,000 in 1905 for capital stock of $35,299.22.

It was held that the receipt of the dividend in liquidation reflected a loss, which, however, was an intercompany loss, and the amount was properly added to the net result of the individual operations to obtain the correct amount of the consolidated net income.

It was held, in solicitor's opinion 131, that—

"Gain is realized on the distribution in liquidation of the assets of a corporation to another corporation, which is the owner of all its stock, * * * and is subject to tax under section 10 of the revenue act of 1916 as amended. Where such companies are required to file consolidated returns for the purpose of the excess-profits tax, liquidation is an intercompany transaction and the gain derived therefrom is not subject to tax under section 201 of the revenue act of 1917."

2. *Good will of International Magazine Co.*—The taxpayer claims that it has good will, which it acquired with tangible assets as follows:

Acquired in 1905 in acquisition of Cosmopolitan Magazine Co.:		
For stock	$25,000	
For bonds	487,500	
		$512,500.00
Acquisition of New Publishing Co. for bonds		941,290.50
Acquisition through Mrs. Hearst in 1914		1,499,982.32
Total		2,953,772.82

Referring to the amount acquired through Mrs. Hearst ($1,499,982.32), the following explanation is made:

On February 28, 1914, Mrs. W. R. Hearst was indebted to the International Magazine Co. in the amount of $1,059,931.88, which amount the corporation carried on its books as an asset. At the same time Mrs. Hearst owned the total stock of the following corporations in the amounts indicated:

World Review Co	$250,000
American Home Magazine	10,000
Harper's Bazaar (Inc.)	10,000
National Magazine Co. (Ltd.)	100,000
Total stock (par value)	370,000

Mrs. Hearst offered to sell her stock of the four companies last above mentioned to the International Magazine Co. in consideration of the cancellation by it of the $1,059,031.88 indebtedness which she owed to it. The board of directors of the International Magazine Co. accepted Mrs. Hearst's offer and proceeded to liquidate and merge the newly acquired companies with the exception of the National Magazine Co., which was a foreign corporation.

The amount of the so-called good will is determined as follows:

Indebtedness canceled	$1, 059, 031. 88	
Less paid for foreign corporation not merged	100, 000. 00	
		$959, 031. 88
Net deficit of the three companies merged		540, 950. 44
Total		1, 499, 982. 32

The International Magazine Co. immediately proceeded to charge off to surplus, $1,341,607.74, of the so-called good will. For the purpose of increasing its invested capital for taxation purposes it contends that the entry should be reversed and the amount considered as good will, which was allowed by the bureau.

At the time the above-mentioned transaction was executed the three companies merged with the International Magazine Co. showed deficits aggregating $540,950.44. The result of this transaction was the cancellation of an asset carried on the books at $1,059,031.88 and the assuming of liabilities of the three corporations merged of $540,950.44 in excess of assets acquired from them, so that its financial condition was impaired to the extent of $1,499,982.32.

The three companies merged with the International Magazine Co. had sustained losses for three years prior to liquidation and were insolvent at the time of the merger. It is contended that no good will was or could be acquired by the International Magazine Co. in absorbing these three insolvent corporations that had operated at a loss for the three years immediately preceding the merger.

It is not only improper to reverse the entry which the company made at the time of the merger in charging surplus with $1,341,607.74, but surplus should be further reduced by $158,374.58 in order that the entire loss should be charged off.

3. *Paid-in surplus, $2,052,683.01.*—The taxpayer claimed and the bureau allowed as paid-in surplus the last above-mentioned amount representing the value of tangible assets of the San Francisco Examiner, which was acquired in exchange for capital stock of taxpayer.

The Examiner Printing Co. was incorporated in 1903 for the purpose of taking over the San Francisco Examiner, which was the personal property of Mr. Hearst and was operated as a sole proprietorship. The actual transfer of the business to the corporation was made during the year 1907.

A balance sheet of the San Francisco Examiner at December 31, 1907, immediately prior to transferring the assets and liabilities to the corporation, was submitted, which was made the basis of a claim for paid-in surplus as follows:

Total assets	$3, 145, 785. 43
Total liabilities	299, 313. 61
Net assets acquired	2, 846, 471. 82
Less Capital stock issued	500, 000. 00
Paid-in surplus	2, 346, 471. 82

An examination of the balance sheet shows that among the assets claimed in the above total were the following:

W. R. Hearst	2, 295, 611. 30
Los Angeles Examiner	326, 450. 98
Total	2, 622, 062. 28

The Los Angeles Examiner was owned personally by Mr. Hearst, so that both of the above accounts are properly debits of the proprietor's account. The credit side of the balance sheet contains among others the following accounts:

W. R. Hearst, capital	$793, 788. 81
Profit and loss	2, 052, 683. 01
Total	2, 846, 471. 82

In order to show a correct statement the debits of the personal account should have been offset against the credits with the following result:

Total assets claimed	$3, 145, 788. 43
Less personal accounts (W. R. Hearst and Los Angeles Examiner)	2, 622, 062. 28
Correct assets	523, 723. 15
Less liabilities	299, 313. 61
Net assets acquired	224, 409. 54

No contention was made on the part of the taxpayer that Mr. Hearst ever paid into the corporation the amount of the debit account. It is evident that Mr. Hearst withdrew from the business the amounts indicated as debits to his personal account and that of th eLos Angeles Examiner—namely, $2,622,062.28—but the company subsequently claims these amounts as paid-in surplus. The net assets acquired were actually valued at $224,409.54, as shown by the balance sheet, which was less than the par value of the stock issued in exchange therefor and therefore there was no paid-in surplus.

It is inconceivable that the bureau should allow this item as invested capital in view of the facts which appear in the record stated above.

4. *Illinois Publishing & Printing Co. leasehold, $400,000.*—The taxpayer claimed the bureau should include in invested capital $400,000, representing the value of a lease assigned by Mr. Hearst to the Illinois Publishing & Printing Co.

At a conference, report of which was made under date of January 19, 1925, the bureau conferees stated that appraisals submitted substantiate this figure, and it is of record the bank which financed the building of this property valued the lease as such. The claim of the taxpayer in regard to this item was therefore allowed. The facts are as follows:

Under date of February 3, 1919, Mr. Hearst leased for a period of 99 years from November 1, 1909, property located at the northwest corner of West Madison and North Market Streets, Chicago, at the annual rental of $10,000 for the first year, $25,000 for the next 19 years, and $30,000 thereafter. The lease contained a provision that Mr. Hearst was to erect a building on the property prior to July 1, 1912, at a cost of $300,000.

Under date of March 15, 1910, Mr. Hearst assigned this lease to the Illinois Publishing & Printing Co., of which he owned practically all of the capital stock.

In 1914 the Illinois Publishing & Printing Co. issued to Mr. Hearst $1,000,000 of its capital stock, $400,000 of which was represented as being in payment of the leasehold. The taxpayer submitted the following as proof of the cash value of the leasehold:

First, that on April 1, 1910, the company issued $800,000 in bonds secured by a mortgage on the leasehold and the building to be erected. Subsequently it issued an additional $500,000 in bonds secured by second mortgage on the leasehold.

Second, an affidavit by Roy D. Keehn dated April 12, 1924, to the effect that before the lease was assigned by Mr. Hearst he had received an offer of a bonus of $5,000 a year for a period of 50 years for a sublease; that he was familiar with the circumstances surrounding the issuance of $800,000 bonds, that said bonds were sold by bankers and that the latter valued the leasehold at $350,000; and that all appraisals have been long since destroyed.

Third, an affidavit dated August 6, 1924, by J. L. Kesner, a Chicago real estate man, who claims to be familiar with the property in question, and that in his opinion said leasehold in 1910 was worth at least $400,000.

The committee contends that the proof submitted by the taxpayer mentioned above is not sufficient evidence on which the bureau should have allowed the taxpayer to claim any valuation of this leasehold for invested capital purposes for the following reasons:

The amount of bonds issued to construct a building is not a fair criterion by which to measure the value of a leasehold. In many instances property has been mortgaged greatly in excess of its value, as in many cases of forced sales property has been sold at an amount which would not suffice to even pay the first mortgage, leaving nothing to apply on the second and subsequent mortgages.

That the affidavit of Mr. Keehn, an attorney for the company, as to the value of the leasehold and the statement of the bankers that in their opinion the leasehold was worth $350,000 is mere opinion evidence (expert or otherwise) and is not acceptable. That the affidavit of J. L. Kesner, Chicago real estate man, however qualified he may be, is mere opinion evidence and not acceptable.

In this connection reference is made to T. D. 3367 (C. B. I-2, p. 243), which amends article 836 of regulations 45 and article 836 of regulations 62 to read as follows:

"The paid-in surplus allowed in any case is confined to the value definitely known or accurately ascertainable at the time the property is paid in. Evidence offered to support a claim for a paid-in surplus must be as of the date of the payment. It may consist among other things of (*a*) an appraisal of the property by disinterested authorities, (*b*) a certificate of the assessed value in the case of real estate, or (*c*) evidence of a market price in excess of the par value of the stock or shares. Opinion evidence, expert or otherwise, of the value of property as of a prior date will not be accepted. Retrospective appraisals submitted in support of a claim for a paid-in surplus will not be accepted in any case where other reasonably satisfactory evidence is available and in any case will be accepted only after rigid scrutiny and will be followed only to the extent to which their reasonableness is fully established * * *."

From all the evidence presented it appears that the acquisition of the lease by Mr. Hearst in 1909 was an open transaction and that all facts then known would have been taken into consideration by the lessor. If the lease had been worth more than the stipulated annual rental, it is only reasonable to assume that such additional value would have been added to the rental charges.

It has not been disclosed that any important events transpired between the date Mr. Hearst acquired the lease and the date it was assigned to the corporation that would increase the value of it, nor is there any evidence that had the lease been acquired by Mr. Hearst in 1910 instead of 1909 the terms would have been less favorable. There is no evidence that the purported offer of a bonus for a sublease referred to in Mr. Keehn's affidavit was a bona fide offer. It is contended that the value of the leasehold was not established and that the bureau should not have allowed any value for the leasehold to be included in invested capital.

5. *Including invested capital money loaned by W. R. Hearst to corporations owned by him.*—The books of the various corporations owned by Mr. Hearst showed that he had loaned to them up to the year 1918, $6,201,556.61, and in 1919 the amount had been reduced to $6,167,321.79. These amounts appear on the books as accounts payable to Mr. Hearst. There was no fixed time for payment of the accounts, they did not bear interest, and no written evidence of the indebtedness was presented to the bureau.

In 1918 the taxpayer took up the matter of including this indebtedness in invested capital with Doctor Adams, chairman of the advisory tax board, and on March 9, 1918, the latter sent the taxpayer a telegram as follows:

"Noninterest bearing permanent indebtedness of a corporation represented by loan from sole stockholder without fixed time of maturity and not evidenced by written obligation may be treated in the return as invested capital as per letter of this date."

On March 13, 1918, Doctor Adams wrote the taxpayer as follows:

"What I meant to convey by the above telegram is that while I have very little doubt about the status of such indebtedness and am willing to have the return of the company concerned made up on the assumption that such indebtedness is part of the capital, the question is nevertheless one which requires careful legal examination, and we must reserve the right to treat this item as a liability rather than invested capital if subsequent examination of legal precedents proves this to be necessary. You will be advised, of course, before any change of this kind is made.

"Attention should be called to this item in the return of the corporation, and you may state that I have informally authorized its inclusion tentatively in invested capital."

On the above authority the taxpayer included the Hearst personal account in its invested capital in submitting its returns for the years 1918 and 1919. In the audit the item was disallowed as invested capital by the Income Tax Unit.

Taxpayer protested to the disallowance in a brief dated November 12, 1921. As a result of this protest a conference was held on November 18, 1921, at which the question was discussed, but the record does not indicate that a decision was reached.

The next A-2 letter, dated August 11, 1922, to the taxpayer allowed this item of borrowed money as invested capital, referring to the above-mentioned conference as authority therefor. There is no evidence in the record to show the authority on which this item was allowed as invested capital.

Section 207 of the act of October 3, 1917, provides that—

"As used in this title 'invested capital' does not include * * * money or other property borrowed * * *."

Section 326 (b) of the revenue act of 1918 provides that—

"As used in this title the term 'invested capital' does not include borrowed capital."

Therefore it is plain that borrowed capital can not be considered as invested capital under either the revenue act of 1917 or 1918.

The character of the advances as liabilities can be definitely determined by a quotation from the taxpayer's own brief referred to above as follows:

"The Internal Revenue Bureau correctly states that these advances represented borrowed money and 'were never considered as paid-in surplus.' They were not paid-in surplus. There was no gift made of them to the companies. Mr. Hearst still claims, and has always claimed, that he is entitled to repayment of such advances at the proper time."

The fact that the advances were considered as liabilities and not capital is evidenced by the following:

On December 31, 1903, the Star Co. of New York was indebted to Mr. Hearst to the amount of $6,119,100.04, representing advances made by the latter. A journal entry was made on December 31, 1903, on the books of the Star Co. closing this account payable into surplus. In 1917, after a lapse of 14 years, this entry was brought to the attention of Mr. Hearst by an accountant who investigated the books. On November 30, 1917, Mr. Hearst addressed a letter to the Star Co. calling its attention to the fact that such entry was unauthorized and requesting that the entry be reversed to show the facts. Mr. Hearst in this letter states:

"Not only have I never authorized any such entries, but so far as I have been able to ascertain no such authorization was given by the board of directors of those companies. Nor was there any authorization of any entries which would in any way affect the credits which, prior to the making of the entries referred to, stood upon the books in my favor and which represented moneys advanced by me to those corporations."

In this connection the following decisions are outlined in order to show the attitude of the unit and the committee on appeals and review in regard to allowing borrowed money as invested capital.

(A. R. R. 1004.) In this case the net profits, by appropriate resolution of the board of directors, were divided pro rata among the stockholders according to their individual holdings and credited to their individual accounts on the books of the corporation. No interest was paid on the accounts. The case was referred by the committee on appeals and review to the solicitor for his opinion. He held that the division of the surplus and the crediting to the stockholders of the amounts in question was, in fact, a dividend and that the personal accounts were liabilities of the corporation and consequently could not be included in invested capital of the corporation.

(A. R. R. 1062.) In this case the corporation credited its net earnings to the personal accounts of its three stockholders. These amounts were left in the business and used by the corporation in conducting its affairs. The committee on appeals and review held that the amounts credited to the stockholders and used by the corporation in conducting its business constituted borrowed capital and consequently could not be included in its invested capital.

(A. R. R. 1984.) All of the stock of this corporation except five shares was owned by A. In 1909 there was established on the books of the corporation an account designated "A personal account," which was carried under the general head of accounts payable. In 1918 the amount standing to the credit of A in this account was credited to surplus. The committee held that the account was a liability and could not be included in invested capital.

The United States Board of Tax Appeals has decided on this question in two recent decisions. In the case of the Consolidated Electric Lamp Co., Docket No. 555, the two principal stockholders had their salary credited to their accounts. They owned the building occupied by the company, and the rent due from it was also credited to their accounts. On December 31, 1918, the balance of their personal accounts was $45,064.63. Taxpayer claimed this amount as part of its invested capital for 1919, which was disallowed by the Income Tax Unit on the grounds that it was a liability, and this decision was confirmed by the Board of Tax Appeals.

In the case of the Electrical Supply Co., all of the stock of which was owned by three stockholders, Docket No. 710, it was the custom at the end of each fiscal year to credit on the books to the personal accounts of the three stockholders the entire net earnings for that year. The accounts were named "stockholders" or "individual surplus accounts." The stockholders had the right to and did draw against such accounts for funds for their personal use, and also had the right to pay into the same amounts obtained by them from sources not connected with the operation of the corporation's business.

In computing its invested capital for taxation purposes the taxpayer included the amount of these accounts. Upon audit of the taxpayer's income-tax returns the commissioner disallowed the amounts credited to the personal accounts mentioned above, and the decision was sustained by the Board of Tax Appeals.

It is a well-settled theory of law that a corporation is an entity separate and apart from the stockholders who own its shares of stock. Under the 1917 and 1918 acts, which prohibited considering borrowed money as invested capital, money advanced to a corporation by a stockholder, regardless of the number of shares owned by him, must be considered as borrowed money under these statutes and therefore is not allowed to be included in invested capital of the corporation.

The fact that Mr. Hearst owned 100 per cent of the stock of the taxpayer does not change the status of the borrowed money to any greater extent than if he owned 1 per cent. The allowance by the bureau of this borrowed money to be included in invested capital is directly contrary to the provisions of both of the revenue acts above mentioned.

Geo. G. Box, *Chief Auditor*

Treasury Department,
Washington, November 12, 1925.

Memorandum to Mr. C. R. Nash; Assistant to the Commissioner.

In re: Star Co., New York, N. Y.

Reference is made to the criticism by the Senate committee relative to the manner in which the Bureau of Internal Revenue closed the case of the above-named taxpayer for the taxable years 1917, 1918, and 1919.

There appear to be six allegations of error made by the Senate committee briefly summarized as follows:

1. That the additional taxes for 1917, 1918, and 1919, as finally determined by the Income Tax Unit were in the respective amounts of $94,823.18, $21,585.03, and $177,931.11.
2. The allowance of a deduction in 1918 from gross income in the amount of $203,964.36 representing a loss in liquidation of the German Journal Corporation.
3. The allowance for invested capital purposes of good will in the amount of $1,499,982.32.
4. The allowance of a "paid-in surplus" for invested capital purposes of $2,346,471.82.
5. The allowance of a value of $400,000 for a leasehold.
6. The allowance for invested capital purposes of sums of money advanced by W. R. Hearst to the different corporations of whose stock he was the owner.

It appears that during the year 1904 the Star Co. acquired 100 per cent ownership of the capital stock of a company known as the German Journal Corporation who owned the publishing rights to a German-language newspaper commonly known as the "Das Morgen Journal." From 1904 to December 31, 1916, the German Journal Corporation accumulated losses in the amount of $205,214.36, which amount the Star Co. set up on its books of account as an account receivable, and when the publication of the German-language newspaper ceased and liquidation of the German Journal Co. took place, the Star Co. claimed as a loss $205,214.36, which has been disallowed by the bureau and not allowed, as your committee states.

With respect to the value of $1,499.982.32, good will, it appears that in February, 1914, Mrs. W. R. Hearst was indebted to the International Magazine Co. in the amount of $1,059,031.88, which amount was carried upon its books as an asset. Mrs. Hearst personally owned capital stock in the following corporations and in the respective amounts noted below:

World Review Co	$250, 000. 00
American Home Magazine	10, 000. 00
Harpers Bazaar (Inc.)	10, 000. 00
National Magazine (Ltd.)	100, 000. 00
Total	370, 000. 00

which she offered to sell to the International Magazine Co. in consideration of the cancellation by it of the $1,059,031.88 indebtedness for which she was liable. The board of directors of the International Magazine ratified the offer and good will was set up on the books in the amount of $1,499,982.32, briefly computed as follows:

Indebtedness canceled	$1, 059, 031. 88
Less amount paid for foreign corporation	100, 000. 00
	959, 031. 88
Net deficit of the three corporations	540, 950. 44
Good will of merged corporations	1, 499, 982. 32

As will be observed from the foregoing, good will was acquired with cash or its equivalent and its allowance was proper.

With respect to the item "Paid in surplus," in the amount of $2,346,471.82, it appears that a company known as the Examiner Printing Co. was organized under the laws of the State of California to take over the business conducted by W. R. Hearst as an individual. Although the corporation was organized in 1903, the completion of the corporate form of ownership did not become effective until some years later. In the meantime there was no change in the ownership, control, or conduct of the business.

A balance sheet of the sole proprietorship as at December 31, 1907, immediately prior to transferring the assets and liabilities to the corporation shows the following:

Total assets	$3, 145, 785. 43
Total liabilities	299, 313. 61
	2, 846, 471. 82
Less capital stock issued	500, 000. 00
Net value	2, 346, 471. 82

Attention is here directed to section 326, part (2), of the revenue act of 1918, which provides that—

"Actual cash value of tangible property, other than cash, bona fide paid in for stock or shares, at the time of such payment, but in no case to exceed the par value of the original stock or shares specifically issued therefor, unless the actual cash value 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."

Upon the showing made by the taxpayer it appears proper to consider the establishment of a paid-in surplus.

With respect to the valuation of $400,000 placed upon the leasehold owned by the Illinois Publishing & Printing Co., who acquired it by the payment to W. R. Hearst of capital stock in the par value of $400,000, it appears that Greenbaum Sons Bank & Trust Co. valued the lease at $350,000 in 1910, and in the same year one J. L. Kesner, a real estate expert, appraised the lease at $400,000. These facts have a strong indication of supporting the value used.

With respect to the sums of money advanced to the corporations by W. R. Hearst, there appears to be ample reason for such allowances in A. R. R. 356, A. R. R. 78, A. R. M. 44, A. R. R. 116, and A. R. R. 237.

You are further advised that the closing of the case for 1917 and 1918 indicates taxes in the respective amounts of $94,823.18 and $99,907.35; for 1919, however, the correct tax has not been finally determined.

After careful consideration of all the items set out by the Senate committee as erroneous in principle or otherwise, I am forced to the conclusion that the closing of the case by the Income Tax Unit was proper and in accord with the law and regulations.

(Signed) C. B. ALLEN,
Assistant Deputy Commissioner.

In re Southland Steamship Co., Savannah, Ga.

Overassessment of $336,181.28 for 1917 was the result of allowance of a reduction in profit from sale of two ships by increasing the cost of same over the cost shown on the books of the taxpayer.

It appears from the taxpayer's brief that there was a partnership, called Walker, Armstrong & Co., engaged in navigation; that this company in 1916 organized the taxpayer and transferred all assets to it; that among such assets were two ships, the *Eurana* and the *Southerner*; that $5,000,000 in stock was issued for all the assets according to the following distribution:

Cash turned over by partnership	$1,681,000.00
Ossabow Island	226,636.04
Fixtures	1,233.21
Good will	940,000.00
Steamship *Eurana*	1,500,000.00
Steamship *Southerner*	651,130.75
Total	5,000,000.00

This distribution was arbitrary, and there was a slight difference in stockholdings from the proportions of ownership in the partnership.

The taxpayer sold the two ships in 1917, the *Eurana* for $2,750,000 and the *Southerner* for $2,875,000. An assessment was based on the profit as computed by deducting from this sale price the cost shown above.

The taxpayer claimed the amounts shown above as costs were arbitrary and that a greater proportion of the payment to the partnership should be allocated to the cost of the ships.

The bureau allowed the amount set up as "good will," $940,000 to be considered a part of the cost of the ships, thus reducing by that amount the profit realized on the sale.

Assuming that the value set by the taxpayer was arbitrary and low, it is easy to see the equity of allowing a greater cost. But, on the other hand, the transaction in 1916 might be held a reorganization, and hence the profit on the sale in 1917 would be based upon the original cost to the partnership, or March 1, 1913, value; no data on this is available to me, but it is safe to infer that a greater profit would result from such basis.

It would seem that if the values set up for the ships are arbitrary that the value set up as "good will" must necessarily be so, and there is no reason for allowing this arbitrary figure of $940,000 rather than any other sum. The case does not show whether there was in fact any good will. If there was, there is no excuse for considering all the good will of a navigation partnership being stowed upon one ship; and if there was not, the allowance is as arbitrary as the taxpayer's telephone number.

It may well be that the taxpayer was entitled to some relief if the claim were properly presented, but the relief given was not based upon anything.

Respectfully submitted.

F. B. POTTER.

NOVEMBER 12, 1925.

MEMORANDUM to Mr. C. R. NASH
Assistant to the Commissioner.

In re: Southland Steamship Co., Savannah, Ga.

Reference is made to the criticism by the Senate committee relative to the manner in which the Bureau of Internal Revenue closed the case of the Southland Steamship Co., Savannah, Ga., for the taxable year 1917.

It appears that during the year 1916, Walker, Armstrong & Co., a partnership composed of (1) I. D. M. Strachan, (2) J. S. Armstrong, (3) J. P. Walker, (4) R. W. Groves, (5) H. G. Strachan, owned and operated a steamship known as the *Eurana;* they also owned a contract with the Union Iron Works for the completion of another steamship to be known as the *Southerner.*

The above-named partners in the latter part of 1916 organized a company to be known as the Southland Steamship Co., to take over the assets of the partnership. The Southland Steamship Co. issued $5,000,000 in capital stock, which was paid for in cash. The corporation then purchased from the partnership of Walker, Armstrong & Co. their equity in the steamship *Eurana* and *Southerner* (partly completed).

The cost of the steamship to the taxpayer corporation is really the matter in dispute, and when it is considered that an offer was made by disinterested parties of $2,100,000 for the steamship *Eurana*, representing an average of $224.59 a dead-weight ton, which offer was made on June 8, 1916, and repeated on June 22 and June 24, 1916, both steamships would have been worth $4,682,877 instead of the amount allowed in closing the case—namely, $3,701,697.30.

In view of the fact that the taxpayer has presented proof in the form of a bona fide offer for one of the steamships in question on or about the time they were sold to the taxpayer corporation, I am constrained to view the value used by the Income Tax Unit as cost to the taxpayer corporation proper and in accord with the law and regulations.

(Signed) C. B. ALLEN,
Assistant Deputy Commissioner.

Cyrus H. K Curtis

(By Geo. G. Box, June 11, 1925)

JUNE 11, 1925.

To: Mr. L. C. Manson, general counsel.
From: Mr. George G. Box, chief auditor.
Subject: Cyrus H. K. Curtis, Curtis Publishing Co., and Public Ledger Co., Philadelphia, Pa.

Mr. Cyrus H. K. Curtis, according to the records, owned in his own name 36,250 shares of the capital stock of the Curtis Publishing Co., and 2,994 shares of the Public Ledger Co. on December 31, 1918. The total number of shares issued and outstanding on that date were 250,000 and 3,000, respectively. The holders of the issued and outstanding stock of the two companies are shown in the attached statement (Exhibit A).

An examination of the returns of the above-named taxpayers shows that the Public Ledger Co. operated at a deficit of approximately $500,000 for each of the years 1918 and 1919, $50,000 for 1920 and $2,000,000 for the year 1921. These amounts are exclusive of dividends, which it received from the Curtis Publishing Co., referred to hereafter, and which are not subject to tax under section 234 (a) (6), revenue act of 1918, to the Public Ledger Co.

The net income of Mr. Cyrus H. K. Curtis was approximately as follows: For the year 1917, $2,000,000; 1918 and 1919, $1,000,000; 1920, $800,000; 1921, $700,000; 1922, $1,100,000; and for 1923, $1,200,000.

The net income of the Curtis Publishing Co. was approximately for the years 1917 and 1918, $6,000,000; 1919, $8,000,000; 1920, $10,000,000;1921, $7,000,000; 1922, $13,000,000; and for 1923, $13,500,000.

As shown above, the Curtis Publishing Co. earned large profits during the years in question, while the Public Ledger Co. operated at a deficit. Mr. Curtis owned practically all of the stock of the Public Ledger Co. and over 50 per cent of the stock of the Curtis Publishing Co. early in 1917. During the year 1917 he transferred 50,000 shares of his stock in the Curtis Publishing Co. to the Public Ledger Co. He made a further transfer to the Public Ledger Co. of 40,000 shares of the Curtis Publishing Co. during 1918. In 1920 and 1921 the Public Ledger Co. received stock dividends of the Curtis Publishing Co. of 11,911 and 3,970 shares, respectively. On these shares the Public Ledger Co. received cash dividends in the following amounts:

	Dividends
1917	$575, 000. 00
1918	825, 070. 00
1919	1, 890, 000. 00
1920	1, 597, 636. 23
1921	1, 642, 596. 89
Total	6, 530, 303. 12

As far as the record discloses no dividends were paid to Mr. Curtis by the Public Ledger Co. during the years from 1917 to 1921, inclusive.

The revenue agent in his report expressed the view that the transfers of stock mentioned above were for the purpose of escaping tax.

The question of the propriety of the transfer of the stock by Mr. Curtis was reported to Solicitor Gregg of the Internal Revenue Bureau for consideration, and in a memorandum dated May 13, 1925, to Deputy Commissioner Bright, he stated as follows:

"On account of the large taxable income reported in each year it may be reasonably concluded it was the purpose of taxpayer to escape the additional tax which would have resulted had he retained all of the Curtis Publishing Co. stock and included the dividends in his own returns, but were the returns fraudulent? The only information in the record tending to show the taxpayer's intent is a statement attributed to a Mr. Whaley, who was a former editor and director of the Public Ledger Co. to the effect that he (Whaley) had heard Mr. Martin, a stepson-in-law of Mr. Curtis, say he had a scheme whereby he could save Mr. Curtis a million dollars on tax under the act of October 3, 1917. Mr. Whaley was interviewed, but denied he had heard Mr. Martin make the statement in question. He further denied knowledge of the transfers of the stock to the Ledger Co. until January 1, 1924. He also denied being present at any meeting of the Ledger Co. when the stock transfers took place. In this connection the agents show that Mr. Whaley had received a statement of the financial condition of the Public Ledger Co. in his official capacity each month and that the minute book of the Ledger Co. as of May 22, 1917, shows that Mr. Whaley was present at a special meeting of the stockholders of the Ledger Co. when a part of the stock was transferred. The Public Ledger Co.'s books show that the stock was written up on them at its par value of $5,000,000. It may well be that Mr. Martin did make the statement and that he did have a plan for so arranging Mr. Curtis's income as to reduce his tax liability. If he did have such a plan and if Mr. Curtis regarded the plan as a legal one and put it in execution, it would not necessarily follow that the plan was fraudulent. The Public Ledger Co., as already stated, was operated at a loss, and Mr. Curtis owning all but three shares of its stock was accustomed to making up the deficiencies out of his personal funds. It may be that he regarded the transfers of the stock of the Curtis Publishing Co. to the Ledger Co. merely as a means of balancing his budget and making the Public Ledger Co. self-supporting independently of his personal contributions to it.

"While the information in the record shows the taxpayer was in control of the Public Ledger Co. through stock ownership, there is no evidence tending to show the transfers of stock to it were not legally or regularly made, nor is there any evidence in the record warranting a conclusion that Mr. Curtis retained any beneficial interest in the stock of the Curtis Publishing Co. so transferred above or beyond that incident to ownership of the stock of the Ledger Co. This office is of the opinion the evidence does not warrant a finding that the transfers were illegally made, nor made willfully with intent to evade tax, and neither additional tax nor fraud penalty should be proposed or assessed.

"It is recommended, however, that an investigation of the Public Ledger Co. be made to determine the tax liability, if any, of Mr. Curtis, under section 220 of the revenue acts of 1918 and 1921. Your file is returned herewith."

When the case was obtained by the committee from the unit, it contained a letter by the Deputy Commissioner to the internal-revenue agent in charge at Philadelphia which evidently was about to be mailed, requesting him to submit a report covering an investigation to ascertain if the Public Ledger Co. has been availed of to defeat the surtax, as provided by sections 220 of the revenue acts of 1918 and 1921, stating that—

"It appears that the Public Ledger Co., which is controlled by Mr. Curtis, has had large earnings but paid no dividends for the years 1918 to 1921, inclusive."

While it is quite probable that the transfer of stock was made by Mr. Curtis for the purpose of reducing his tax, it is a fact that had the transfer not been made he would have been required to pay surtaxes on all of the dividends he received from the Curtis Publishing Co. and he could not obtain the benefit of a deduction from his income on account of the losses sustained by the Public Ledger Co., of which he owned practically all of the stock.

It is believed that the action recommended by the solicitor to determine the tax liability of Mr. Curtis under section 220 as regards the undistributed earnings of the Public Ledger Co. is the proper solution of this question.

The surplus of the Public Ledger Co. at the end of the year 1921 was in excess of $8,000,000. This company at the present time is constructing an immense new building in Philadelphia. It is altogether probable that when the investigation suggested by the solicitor is made, the company will defend its action in not distributing its surplus on the ground that it had this building program in anticipation.

Copy of section 220 of the revenue act of 1918 is attached (Exhibit B).

Respectfully submitted.

GEO. G. BOX, *Chief Auditor.*

EXHIBIT A

Number	Name	Relation to the other stockholders and official connection with company	Company 1—Curtis Publishing Co.—number of shares held	Company 2—Public Ledger Co.—number of shares held
1	Edward W. Bok	Son-in-law of 4	6,865	
2	Marie Louis Bok	Daughter of 4	2,100	
2½	E. H. Collins	Brother of 3	230	
3	P. S. Collins	General business manager of 1.	3,995	1
4	C. H. K Curtis	President (' companies 1 and 2.	36,250	2,994
5	Kate S. Curtis	Wife of 4	147	
6	C. H. K. Curtis, trustee of estate of L. C. Curtis.	Deceased wife of 4	20,120	
7	Mrs. Mary Collins	Wife of 3	2,030	
8	W. D. Fuller	Secretary of company 1	189	
9	Girard Trust Co., trustee under deed of E. W. Bok.	See No. 1	12,000	
10	Katharine Ludington	Sister of 12	713	
11	Ethel Ludington	Wife of 12	4,300	
12	C. H. Ludington	Vice president and treasurer, company 1.	9,135	1
13	C. T. Ludington	Son of 12	100	
14	Mary L. Ludington	Sister of 12	713	
15	W. H. Ludington	Brother of 12	925	
16	W. H. and C. H. Ludington and A. G. Rotch, trustees.	See No. 12	475	
17	J. C. Martin	Treasurer of company 2; son-in-law of 4.	62	1
18	Public Ledger Co		90,000	
18½	Mrs. H. G. Rotch	Sister of 12	950	
19	J. B. Williams		1,425	1
19½	Lloyd Soltus	Brother-in-law of 12	1,600	
20	C. H. K. Curtis, trustee, Curtis Publishing Co. of Pennsylvania.	See No. 4	118	
21				
21½	Employees and wives		17,993	2
22	Minority interest		37,595	
	Total outstanding shares		250,000	3,000

EXHIBIT B

SECTION 220 OF THE REVENUE ACT OF 1918

SEC. 220. That if any corporation, however created or organized, is formed or availed of for the purpose of preventing the imposition of the surtax upon its stockholders or members through the medium of permitting its gains and profits to accumulate instead of being divided or distributed, such corporation shall not be subject to the tax imposed by section 230, but the stockholders or members thereof shall be subject to taxation under this title in the same manner as provided in subdivision (e) of section 218 in the case of stockholders of a personal service corporation, except that the tax imposed by Title III shall be deducted from the net income of the corporation before the computation of the proportionate share of each stockholder or member. The fact that any corporation is a mere holding company, or that the gains and profits are permitted to accumulate beyond the reasonable needs of the business, shall be prima facie evidence of a purpose to escape the surtax; but the fact that the gains and profits are in any case permitted to accumulate and become surplus shall not be construed as evidence of a purpose to escape the tax in such cases unless the commissioner certifies that in his opinion such accumulation is unreasonable for the purposes of the business. When requested by the commissioner, or any collector, every corporation shall forward to him a correct statement of such gains and profits and the names and addresses of the individuals or shareholders who would be entitled to the same if divided or distributed, and of the amounts that would be payable to each.

TREASURY DEPARTMENT,
Washington, October 30, 1925.

Hon. JAMES COUZENS,
Chairman Senate Investigating Committee.

DEAR MR. CHAIRMAN: Reference is made to the report submitted by the representative of the Investigating Committee with reference to the cases of Cyrus

H. K. Curtis of the Curtis Publishing Co. and of the Public Ledger Co. In a concluding paragraph of his report the committee's representative states that "it is believed that the action recommended by the solicitor to determine the tax liability of Mr. Curtis under section 220 as regards the undistributed earnings of the Public Ledger Co. is the proper solution of this question."

I am very much pleased to note that the report of the committee's representative on this case involves no criticism of the action of the bureau, but, on the contrary, approves what the bureau has done in this matter. I assume consequently that no further report from the bureau on this case is desired by the committee.

Sincerely yours,

(Signed) D. H. Blair,
Commissioner.

In re: Hamon and Colcord, Oklahoma City, Okla.

Overassessment for year 1917 was allowed for $293,837.56 on the ground that whereas Hamon and Colcord filed return as a partnership and paid excess-profits tax as such; that the business was not a partnership but the relationship was that of "colessees engaged in a joint enterprise conducted by a common agent"; and that, therefore, there was no tax liability.

It appears that Jake L. Hamon and Ray Colcord obtained an oil lease; that Hamon managed the business; that the expenses were shared equally; that thereafter Ray Colcord's 50 per cent interest was divided with his brother, C. F. Colcord; that the oil was sold to a pipe-line company and payment therefor was made to each party in interest in accordance with distribution orders filed with the pipe-line company.

It appears the enterprise maintained a fund under the name of Hamon and Colcord, drew checks, and made notes, etc. By mutual agreement Hamon did all the active management.

The committee of appeals and review held this not a partnership on the ground that some of the essentials of a partnership were lacking. There was no "delectus personæ," the Colcords could not "bind Hamon," and there was no "intention" to become partners.

Mr. Mechem, somewhat of an authority on the subject, defines a partnership as "a legal relation based upon the express or implied agreement of two or more competent persons whereby they unite their property, labor, or skill in carrying on some lawful business as principals for their joint profit."

The business in question, according to the facts above stated, appears to me to fall within the above definition. The delectus personarum is not a test of partnership but is a characteristic which may or may not be present. The fact of mutual power to bind each other is not a test, and its use as a test involves the fallacy of petitio principii, for that is the question to be decided, as it will follow not precede the determination of the relation. Anyway partners may inter sese agree that only certain ones may exercise authority of making contracts.

The contention that Hamon and Colcord had no "intention" to be partners is irrelevant. The only question of intent is did they intend to do those acts to which the law attaches a significance termed "partnership." They certainly intended to obtain the lease, they intended to operate it as principals for their joint profit, and they intended to agree to same.

So much importance was given the delectus personarum element that I wish to illustrate the fallacy. Suppose a partnership among A, B, and C. Let C sell his interest to X. The A, B, C partnership is destroyed because C can not substitute a stranger in his place, making him a partner of A and B against their will. Now let A, B, and X continue operating with A and B registering no dissent. The result is a new partnership A, B, X. Now the new partnership is not liable for the old partnership obligations or taxes, but it is liable for its own.

Now, let us suppose that this oil business is peculiar and not to be judged by reference to general business.

In 27 Cyc. 755 a mining partnership is said to arise "when two or more coowners of a mining claim actually engage in working the same and share according to the interests of each in the profit and loss, although there is no express agreement between them to become partners or to share the profits and losses." On this point Federal decisions are cited: Kahn *v.* Central Smelting Co. (102 U. S. 641; G. V. B. Mining Co. *v.* Hailey Bank (95 Federal 35).

One would infer from the language of the committee of appeals and review and from the solicitor's memorandum that the ruling in this case has been generally applied to the oil business, as a number of solicitors' opinions are cited and former cases before the bureau are discussed. The relationship, in accordance then with the usual practice, is determined to be that of "colessees engaged in a joint enterprise conducted by a common agent."

This language on its face is not applicable to the instant case. Hamon could not be a "common agent," he was one of the "colessees," and in managing the business must have acted as principal. One can not be one's own agent. Therefore, Hamon was acting in his own behalf as principal and in behalf of Colcord as agent—the usual partnership manner.

The question here is of importance only in demonstrating the error of the bureau. There would be no difference in tax except under the 1917 law, and the period of the statute of limitations has long since expired.

Respectfully submitted.

F. B. POTTER.

JULY 1, 1925.

TREASURY DEPARTMENT,
Washington, October 30, 1925.

Hon. JAMES COUZENS,
Chairman Senate Investigating Committee.

DEAR MR. CHAIRMAN: Reference is made to the report of the representative of the investigating committee criticizing the action of the bureau in holding that Mr. Hamon and Mr. Colcord, of Oklahoma City, Okla., were not engaged in business as copartners for the year 1917.

I find upon investigation that the question of whether Mr. Hamon and Mr. Colcord were partners in 1917 was decided by the Solicitor of Internal Revenue in 1923 The opinion written in this case was approved by the attorney by whom it was prepared, by five assistant solicitors, and by the solicitor himself. I am attaching hereto a copy of the solicitor's opinion on this question, which, in spite of the criticism contained in the report of the committee's agent, seems to me to be entirely convincing as to the correctness of its conclusion.

The question presented in this case ceased to be of any importance after 1917, a year for which the statute of limitations has long since expired. A controversy at this late date between the committee and the bureau over this question of law, which was decided by competent lawyers after full consideration—and, I believe, correctly decided—can not, in my opinion, serve any useful purpose.

Sincerely yours,

(Signed) D. H. BLAIR,
Commissioner.

MARCH 8, 1923.

In re: Jake L. Hamon, Ray Colcord, and C. F. Colcord

Mr. KINGMAN BREWSTER,
Chairman Committee on Appeals and Review:

You have requested the opinion of this office as to whether the relationship existing between Jake L. Hamon, Ray Colcord, and C. F. Colcord in 1917 was that of a partnership for purposes of income and excess-profits tax.

It appears that on August 12, 1913, Hamon and Ray Colcord secured a lease of a certain tract of land situated in the State of Oklahoma, with a right to the oil and gas therein. The property so leased was to be explored and developed for the production of oil. According to the terms of the lease, Hamon and Colcord were to have an undivided one-half interest in all of the oil and gas produced less a one-eighth royalty interest therein retained by the grantor in said lease. Prior to any development (December, 1913) Ray Colcord assigned his entire interest in the lease to C. F. Colcord. On April 28, 1917, C. F. Colcord assigned back to Ray Colcord one-half of his one-half interest, equaling a one-fourth interest in the lease. The parties contributed to the cost of the development of the property in proportion to their undivided interests therein. Prior to 1916 few books were kept by the enterprise, but subsequent to that date a complete set of books have been maintained and the parties in interest have carried on their transactions under the name of "Hamon and Colcord." In 1917 the interests in the enterprise were as follows: Jake L. Hamon, 50 per cent; Ray Colcord, 25 per cent; C. F. Colcord, 25 per cent.

It appears that by mutual agreement Jake L. Hamon was in active control of the development and operation of the property and his entire time and attention was consumed in the development of this and adjacent properties. No salaries were paid to any of the parties in interest, the profits accruing from the sale of oil being paid directly by the pipe-line companies to the parties in interest in accordance with division orders on file with such companies showing the exact interest of all the parties therein. Each party, accordingly, received a regular check from these companies and contribued his proportionate part to the development and operating expenses of the lease. His account was credited with the amounts paid in by him for developments and expenses and debited with the amounts paid directly by the companies to him. Such funds apparently did not pass through the treasury of the enterprise, but records thereof were made in the books in order that the true condition of the enterprise might be determined and in order that a proper computation of the Oklahoma State tax on gross production could be correctly computed.

The parties have filed affidavits to the effect that there never was any written partnership agreement and that the property at all times was handled as a joint ownership. It is alleged that there never was any intention in the minds of the parties to form a partnership, and although income-tax returns have been filed as a partnership for several years this was due to a misunderstanding by the parties as to their liability to the Government for such returns of income. The only source of income to the enterprise was the sale of oil, which in 1917 produced $589,746.97. This was not joint income, but was paid directly to the parties by the pipe-line companies. There was also income shown in this year in the amount of $74,983.13 from the sale of steel tanks. It appears that this latter item of income passed through the funds of the enterprise and was distributed to the parties in proportion to their interests. However, it has been stated that the money with which these tanks were purchased was advanced by the parties in proportion to their interests and that the amounts received on the sale of the tanks, which actually were sold at a loss, naturally were returned to the parties as a return of capital. There was really no profit made in these sales of oil tanks.

The enterprise maintained a fund under the name of Hamon and Colcord, and many checks were given in payment, some of which were signed "Hamon and Colcord," others "Hamon and Colcord, by Jake L. Hamon," and still others "Hamon and Colcord, by Frank L. Ketch." The latter-named person is administrator of the estate of Jake L. Hamon, the latter having died in 1920. Many notes were given by the enterprise, the majority of which were indorsed only by Jake L. Hamon, although there were two or three indorsed jointly by Jake L. Hamon and C. F. Colcord. Upon Jake L. Hamon's death in 1920 the enterprise was continued by the administrator of Hamon in conjunction with the other parties, in pursuance to a court order granting authority for such continuance. The name "Hamon and Colcord" was not shown in the telephone directory for any year, nor was the name ever printed on the door or office windows of such enterprise, nor did the business ever use letterhead paper bearing the name "Hamon and Colcord." However, the following entry appears in the city directory for 1918 and 1920: "Hamon and Colcord (Jake L. Hamon, Chas. F. Colcord), oil producers, 211 Von Weise Building." It is alleged that the parties were not responsible for this entry.

This office has decided on previous occasions that mere coownership and operation of oil leaseholds, each coowner contributing a pro rato share of the investment and cost of operation and each sharing in the profit, did not, without more, create a partnership taxable within the meaning of the excess profits law of 1917. The facts in the instant case have been carefully studied with a view to determining whether or not they can be considered such as to take the case without the rulings previously made by this office. However, it is believed that the case now being considered is no different in any material respects from those previously passed upon by this office. In the case which gave rise to S. M. 612, November 15, 1918, seven persons joined in an oil lease, each to have a one-seventh interest therein and to bear one-seventh of the expense incurred in obtaining the lease and in the subsequent development of the property and were to be entitled to one-seventh of the profits, if any. None of the parties to the agreement was empowered to act for his associates. The expenses incurred were at all times paid, as in the instant case, by levying an assessment upon each associate for one-seventh part thereof. The Cumberland Pipe Line Co., the purchaser of the oil produced, credited each of the individual owners to the extent of their undivided interest for all oil purchased, and no credit was ever given on the books of the pipe-line company to any partnership or corporate entity for the purchase price of such oil. In these respects the case is similar to the one under consideration. This office, in determining in that case whether a partnership existed for the purposes of the excess-profits tax, concluded as follows:

"In determining the application of the excess-profits tax to partnerships, the usual conception of the word 'partnership' must be considered. In the case in question the partners did not esteem themselves as such. There was absent the element of mutual dependency or agency between coowners. There was no common fund which was credited to a partnership entity. All expenditures for development of the property of the tenants in common was procured by assessment of the individual persons. All the income accruing from the development of the property was credited direct to the individual owners in proportion to their respective interests. There was present no delectus personae. Any of the owners could have, at any time, sold his share to any outsider with the consent of his coowners. The relationship of the parties, lacking as it does some of the elements of any ordinary partnership, is more nearly that of colessees engaged in a joint enterprise conducted by a common agent. It is consequently held that a partnership does not exist within the meaning of the excess profits tax law."

A similar case involving a relationship existing in the State of Oklahoma was decided in S. M. 599, November 12, 1918. The result reached therein was that the coowners of the oil lease were not partners, and the following pertinent remarks were made therein:

"There seems never to have been an intention to form a partnership. There was no partnership agreement. No presumption of partnership between coowners of oil lands arises from the fact that they are jointly engaged in mining the oil." (Holtin *v.* Guinn, 76 Fed. 96; Neill *v.* Shamburg (Pa.), 27 At. 992.)

"In the case at hand, either coowner could sell his part of the leaseholds and his grantee could compel recognition of his rights. On the other hand, neither coowner could sell the interest that belonged to the other. These facts show that there was no partnership." (Logan *v.* Oklahoma Mill Co., 14 Okla. 402, 79 Pac. 103.)

In the case of Norbeck and Nicholson, it was held in S. M. 1119 that such a relationship was a partnership, this conclusion being based on the fact that the name "Norbeck and Nicholson" was used on several occasions in conducting the business. These two persons were contributors with others to a fund to develop and operate an oil field with an agreement that they were to share pro rata in the profits. However, when that case again came before this office, S. M. 1119 was overruled, and on the authority of S. M. 612 it was held that the relationship was not a partnership, but that of colessees engaged in a joint enterprise conducted by a common agent. In that case, as in the instant one, the parties stated under oath that they never intended a partnership. The intention of the parties as gathered from the whole circumstances and the evidence in the case should be considered. (Shea *v.* Nilims, 132 Fed. 209.) Likewise, in that case the name of Norbeck and Nicholson had been used in the city directories, but inasmuch as the parties disclaimed all the responsibility for it and there was no evidence sufficient to fix the responsibility upon them, the use of such name was considered unimportant. Although it was stated in that case that because of the use of the name Norbeck and Nicholson in several transactions, either of the parties could be estopped from denying a partnership liability in the case of persons who were misled and dealt with the firm relying on this misrepresentation, such holding out as a partnership to third parties did not necessarily create a partnership inter sese, which is necessary in order to hold a realtionship to be a partnership for Federal income-tax purposes.

It is believed, therefore, that the facts in the instant case, as in the previous cases considered by this office, disclose a lack of the essential requisites of a partnership inter sese, and that for purposes of the excess-profits tax of 1917 the relationship existing between Jake L. Hamon, Ray Colcord, and C. F. Colcord should be considered as that of colessees engaged in a joint enterprise conducted by a common agent. A sharing of profits is not conclusive of the existence of a partnership, but merely raises a presumption of partnership. Here there were in reality no profits passing through the joint account. Such profits were paid directly by the companies to the parties in interest. The element of mutual agency and dependency was lacking, as it is alleged the Colcords had no authority to bind Hamon, but that Hamon, as common agent, was granted such authority to bind the enterprise. The intention to form a partnership, which is the vital requisite of a partnership inter sese, is doubtful. The individuals would, undoubtedly, be held liable to third parties as partners on the ground of estoppel, but that does not make them partners as among themselves. The parties could dispose of their interests at will.

Accordingly the enterprise itself should not be liable for such excess-profits tax, but the individuals thereof are subject to such excess-profits tax on the profits derived from the enterprise. Since the parties are not partners, they become liable individually for excess-profits tax assessed on the profits arising from their respective interest in the joint property, as the source of the profits is the business or trade of each individual. The fact that the Colcords devoted no or little time to the particular business is of no importance, inasmuch as they had an agent, Mr. Hamon, who devoted part, if not all of his time, to the management of the property for their benefit. Inasmuch as the agent is engaged in the trade or business, his acts are the acts of the principals, and it necessarily follows that the principals are engaged in the oil business and are subject to excess-profits tax on their income accruing therefrom. (S. M. 612.)

NELSON T. HARTON,
Solicitor of Internal Revenue.

In re Henry F. du Pont, Winterthur, Del.

Certificate of overassessment of $353,980.24 income tax for 1918 was issued in 1923.

The taxpayer is a farmer. His original return for 1918 showed a net income of $641,497.80, upon which he paid a tax of $353,980.24.

In June, 1920, the taxpayer filed a claim for refund of the whole 1918 tax based upon the following reasons:

"On January 1, 1918, claimant owned 11,401 shares of the common capital stock of E. I. du Pont de Nemours Powder Co., acquired prior to March 1, 1913. On March 1, 1913, the fair market value of said stock was $180 per share, as heretofore decided by the Income Tax Unit of the Internal Revenue Bureau. On January 15, 1918, the capital stock of theE. I. du Pont de Nemours Powder Co. was reduced to 10 per cent of its previous par value, and claimant received as a liquidating dividend 10,260.9 shares of the debenture stock of the E. I. du Pont deNemours & Co. of the then fair market value of $95 per share, or $974,785.50. On or about January 15, 1918, claimant exchanged said 11,401 shares of said E. I. du Pont de Nemours Powder Co. stock, then of a par value of $10 per share, for 1,140.1 shares of the debenture stock of the E. I. du Pont de Nemours & Co. of the then market value of $95 per share and $7,980.70 in cash. Claimant was entitled to claim the following loss on the above-stated facts as a deduction against his income for the year 1918, none of which loss was so deducted in his return for the year 1918 filed on March 15, 1919, to wit:

"11,401 shares of E. I. du Pont de Nemours Powder Co. at $180 per share		$2,052,180.00
"From which there is to be deducted 10,260.9 shares of the debenture stock of the E. I. du Pont de Nemours & Co. of the value of	$974,785.50	
"And 1,140.1 shares of said stock of the value of	108,309.50	
"And cash of	7,980.70	
	1,091,075.70	
"Or a total sum to be deducted of		1,091,075.70
"Leaving claimant's loss for the year 1918		961,104.30

"As shown by claimant's original return, filed March 15, 1919, his taxable income for the year 1918 was $641,497.80, and the tax thereon paid by claimant for said year 1918, was $353,980.24. Claimant's loss for the year 1918, as shown above, having been $961,104.30 and his erroneous income having been stated at $641,497.80, his loss for the year was greater than his income and he therefore owed no tax for the year 1918 Having erroneously paid a tax of $353,980.24, claimant seeks a refund of said last-mentioned amount.

"Your claimant submits herewith the receipt issued to him by the collector of internal revenue for income taxes for the year 1918."

The method of computing the above loss under the regulations would be to deduct the total of cash and market value of stock received by taxpayer from either the March 1, 2913, value or the original cost, if acquired prior thereto, whichever was the lesser.

Hence a very important factor in the computation of the loss—that is, the original cost—was not shown. There is no evidence among the photostats furnished indicating that such cost was ascertained by the bureau, although reference is made in the certificate of overassessment to a revenue agent's report, dated August 2, 1922.

In view of the well-known facts that 1913 was a year of peace, that the World War began in 1914, and that the E. I. du Pont de Nemours Corporation was more active from 1914 to 1918 than at any other time in history, it seems absurd that one owning stock in this corporation in 1913 could suffer a loss by disposing of such stock in January, 1918, if all the transactions were made in good faith.

The fact that the taxpayer returned a net income of $641,497.80 for 1918 and paid a tax thereon of $353,980.24 is no evidence that he is not entitled to the loss claimed, but it is an indication that such loss was not sensed very keenly at the time it occurred, and it should cause the bureau to scrutinize all the transactions by which such "loss" is effected.

The transaction above described when studied in connection with current financial records seems to be a part of a reorganization plan adopted in 1915.

It appears that this business had been in continuous operation since 1802, first as a partnership, later, since 1903, as a corporation, the E. I. du Pont de Nemours Powder Co. In 1915 this company, hereafter called the old company, organized the E. I. du Pont de Nemours & Co., hereafter called the new company. The plan was as follows:

The old company transferred all assets to the new company. The new company was to pay the old company $120,000,000—i. e., $1,484,100 cash, $58,854,200 common stock, and $59,661,700 debenture stock. The common stock in the new company was issued to the stockholders of the old company as a dividend. The debenture stock was made exchangeable with the common stock of the old company. The new company continued operations and the old company closed out, its stockholders gradually exchanging the old common stock for the new debenture stock.

The new debenture stock differed from the new common stock in preference as to assets and dividends and voting power.

Assuming that the transaction as related by the taxpayer was a part of the above reorganization, the fallacy of the computation of the loss is made demonstrable. The claim is that stock held on March 1, 1913, received in liquidation certain cash and certain debenture stock, which cash and debenture stock had a total value less than the March 1, 1913, value of the original stock. Now the company in which the original stock was held ceased to operate in 1915 and started liquidation when the common stock in the new company was distributed as dividends. Hence the value of the common stock in the new company should be added to the cash and debenture stock received in 1918.

If it is considered that the resolution passed in 1915 by the old company followed in that year by transfer of its assets to the new company and distribution of the new stock as dividends together with final calling in of the old stock in 1918 constitutes in entirety a liquidation, then the whole amount received or $790 per share less the March 1, 1913, value or $180 per share or $610 per share would be taxable income in the years received, in which case the "loss" in 1918 is improper and the refund is illegal.

Or if it is considered that the transaction in 1915 was a reorganization and that the old and new companies were identical, then there would be no gain and no loss and the refund in 1918 would be illegal.

It seems on the facts as they actually existed that one or the other of these must be correct. To review the facts: The old company voted in 1915 to reorganize, change its capitalization, and get under the law of a different State; in that year the new company was organized and all the assets of the old were transferred to the new as a going concern; common stock and debenture stock of the new was transferred to the old; the common stock was distributed to the old stockholders; part of the debenture stock and a small amount of cash was used to call in all outstanding bonds and preferred stock of the old company; the remainder of the debenture stock was used to call in the old common stock the last being done in 1918; and the old company did nothing between 1915 and 1918 except liquidate.

With the foregoing situation before the bureau, their method of handling it constitutes, in my opinion, one of the clearest instances of gross mismanagement and inefficiency on the part of the legal staff and the most inexcusable violation of their duty to protect the interests of the United States. This is what happened.

One Phellis, a small stockholder in the old company, was assessed income tax for the year 1915 on the receipt by him of the common stock of the new company. Phellis held 250 shares in the old company. The March 1, 1913, value was fixed at $180 per share and the 1915 value was fixed at $795 per share. The value of the common stock received by Phellis was fixed at $347.50 per share, and he received two shares for each one share of old stock held. The assessment was upon this value for all the common stock in the new company received by him on the theory that this was a dividend in kind, and that it was paid by a going concern and that it was all income, since the capital was still represented by the $100 value of the old common stock retained—its par being $100.

This was of course incorrect, because the basis was the March 1, 1913, value, which was $180 per share, and hence a payment on this stock reducing it to $100 per share was either a return of capital of $80 per share or a dividend on surplus earned prior to March 1, 1913, and hence not taxable under any theory to the extent of $80 per share.

Phellis sued in the Court of Claims and obtained judgment in his favor for the full amount of the tax paid on the ground that the transaction in 1915 was a reorganization and that the new shares received represented the very same assets and the identical business as the old shares. By thus losing its case the Government was in a very favorable position and the taxpayer having won could not appeal.

Then in June, 1920, the claim for refund on account of "loss" in 1918 was filed by H. F. du Pont (and I suppose by other large stockholders).

At this point the bureau was in position to disallow the "loss" in 1918, a high tax year, and the only question between the taxpayer stockholders and the bureau would be whether an additional tax should be assessed upon the liquidation profits received in 1918.

But after this claim for refund was filed and with the import of the situation clearly presented, the bureau took the case of the little stockholder, Phellis, with its incorrect statement of facts and appealed to the Supreme Court of the United States. The decision of the Court of Claims was reversed, the suit of Phellis dismissed, and the stock received in 1915 held taxable. In 1923 the claim of H. F. du Pont was allowed on the ground that he sustained a "loss" upon the transfer of the old shares of stock for more stock in the new company in 1918, using the March 1, 1913, value of $180 as a basis.

The case of United States *v.* Phellis (257 U. S. 156), referred to above, was decided in 1921, after all the transactions between the companies had been effected, and yet the court has for its facts the following:

"From the findings of the Court of Claims, read in connection with claimant's petition, the following essential facts appear: * * * The personnel of the stockholders and officers of the two corporations was on October 1, 1915, identical, the new company having elected the same officers as the old; and the holders of common stock in both corporations had the same proportionate stockholding in each. After the reorganization and the distribution of the stock of the Delaware (new) corporation, the New Jersey (old) corporation continued as a going concern, and still exists, but, except for the redemption of its outstanding bonds, the exchange of its debenture stock for its preferred stock, and the holding of debenture stock to an amount equivalent to its own outstanding common and the collection and disposition of dividends thereon, it has done no business. It is not, however, in process of liquidation * * *."

It is quite evident from the above that the court was not informed of the facts, although the above inconsistent statement concerning liquidation should not deceive anyone.

The dissenting opinion appears to be very good. It holds the transaction to have been a reorganization, confirming the Court of Claims.

Thus with the able, though perhaps unconscious, assistance of the bureau, the stockholders in a company with almost fabulous earnings from 1913 to 1918 were allowed "losses" on the liquidation of stock in such company at its peak period of prosperity, January, 1918, such losses being deducted from 1918 income aggregating $21,807,045.30, assuming that there was no preference given H. F. du Pont over the other stockholders.

Respectfully submitted.

F. B. POTTER.

TREASURY DEPARTMENT,
Washington, October 30, 1925.

Hon. JAMES COUZENS,
Chairman Senate Investigating Committee.

DEAR MR. CHAIRMAN. Reference is made to the report of the representative of the investigating committee criticizing the action of the bureau in allowing to Mr. Henry F. du Pont a loss upon the partial liquidation in 1918 of stock which he owned in the E. I. du Pont de Nemours Powder Co.

The first point made by the committee's agent is that under the regulations of the bureau the amount of the loss would be the difference between the amount received upon liquidation and the cost to him of the stock liquidated, or the March 1, 1913, value thereof, whichever was lower, and that the information submitted to the Senate committee does not show that the cost of the stock to Mr. du Pont was ever ascertained or taken into consideration by the bureau in computing the loss. I find upon investigation of the bureau records, however, that the facts as to the cost of the stock were ascertained and given proper weight. According to a revenue agent's report dated June 28, 1922, which was accepted by the bureau as correct, Mr. du Pont acquired his stock in the E. I. du Pont de Nemours Powder Co. of New Jersey in 1912 at a cost of $195 per share. Inasmuch as this is higher than the March 1, 1913, value, the amount of the loss was properly computed on the basis of the latter value.

The second criticism is that the bureau should have ignored the transaction taking place in 1915 (that is, the organization of the E. I. du Pont de Nemours & Co. and the distribution to the stockholders of E. I. du Pont de Nemours Powder Co. of New Jersey of a portion of the common stock of the Delaware company), collected no tax upon the transaction which was the subject of the decision of the United States Supreme Court in the case of U. S. *v.* Phellis (257 U. S. 156), treated that dividend merely as reducing the basis for computing gain or loss upon subsequent sale of the E. I. du Pont de Nemours Powder Co. stock and have taxed Mr. du Pont with a profit on the liquidation in 1918 instead of allowing him a loss. The perfectly obvious answer to this criticism is that if we had ignored the 1916 transaction and attempted to tax Mr. du Pont on a profit on the 1918 transaction he would have objected to our reducing the basis for computing gain or loss by the value of the common stock of the Delaware company (which common stock the Supreme Court in the Phellis case held to have been received by him as an ordinary dividend on his New Jersey company stock) and have claimed instead a loss computed in the same manner as that which was allowed. And if his claim had been denied he could then have gone to court and raised the same point which the Government did in the Phellis case. The court, as shown by the case of U. S. *v.* Phellis, supra, would have sustained this position, the taxpayer would have been allowed his loss for 1918, and the Government would then have been compelled to collect the 1915 tax which was the subject of dispute in the Phellis case, if it had not in the meantime been barred by the statute of limitations.

The third criticism is that the attorneys for the bureau failed to present the true facts to the Court of Claims and the Supreme Court, particularly that they stipulated and permitted the court to find that the E. I. du Pont de Nemours Powder Co. of New Jersey was not liquidated in 1915 and was not even in process of liquidation at the time the Phellis case was commenced. The committee's agent asserts that the company was in fact in process of liquidation from 1915 on and that the partial liquidation in 1918 was only a part of that process. His assertion, however, is without foundation in fact. The E. I. du Pont de Nemours Powder Co. is still in existence to-day, and no steps have been taken to finally dissolve it. No reduction in the par value of its stock and no partial liquidation was ever authorized by the stockholders until January 10, 1918. On the 26th day of April, 1916, its board of directors adopted a resolution declaring it to be advisable to decrease the capital stock of the company by reducing the par value thereof and distributing a proportionate part of the assets. This resolution, however, was never acted upon by the stockholders, and no liquidation, partial or total, actually took place until January 10, 1918. For your information I quote the latter resolution:

"On motion, duly made and seconded, the following resolution was unanimously adopted:

"Whereas this board, on the 26th day of April, 1916, adopted a resolution declaring that it is advisable to decrease the capital stock of the company from sixty million dollars to forty million dollars by reducing the par value of three hundred and fifty thousand (350,000) shares of the common stock authorized by the certificate of incorporation from one hundred dollars ($100) per share to ten dollars ($10.00) per share and by reducing the two hundred and fifty thousand (250,000) shares of preferred stock of the par value of one hundred dollars ($100) each to five thousand shares of the par value of one hundred dollars ($100) each by retiring two hundred and forty-five thousand (245,000) shares of preferred stock owned by the company and that Article IV of the certificate of incorporation be amended accordingly and calling a special meeting of the stockholders to assemble on June 5, 1916, to take action thereon; and

"Whereas the stockholders at an adjourned special meeting held on the 10th day of January, 1918, duly called for such purpose, which meeting had been duly adjourned from time to time from the 5th day of June, 1916, to the 10th day of January, 1918, by the vote of two-thirds in interest of each class of the stockholders having the voting power, voted to decrease the capital stock as advised in the resolution of this board; and

"Whereas the stockholders voting at said meeting as aforesaid have assented in writing to the amendment of the certificate of incorporation of this corporation reducing the capital stock as set forth in said resolution, which certificate of amendment has heretofore been filed in the office of the Secretary of State of New Jersey; and

"Whereas, by the decrease of the capital stock aforesaid, capital assets to the extent of ninety per cent (90%) of the par value of the common stock of this corporation, issued and outstanding, has been made available for distribution to the common stockholders of this company, which distribution in the judgment of the board of directors should be made: Now, therefore, be it

"*Resolved*, That a liquidating distribution of ninety per cent (90%) on the par value of the common stock of this company, issued and outstanding, be made to the common stockholders of record at the close of business on the 10th day of January, 1918, payable immediately in the six per cent (6%) nonvoting debenture stock of E. I. du Pont de Nemours & Co. at par."

I have shown above that each of the specific criticisms made by the committee's representative is without foundation. The criticism of the settlement by the bureau of this case, stated in its simplest form, is as follows: The bureau could, according to the committee's representative, have secured a greater tax if it had not taxed the stockholders of the corporation upon the dividend received in 1915 but had taxed them upon the liquidating dividend received in 1918. The bureau in solving the legal questions presented to it is interested in determining the correct answer to the question presented and not the answer which will produce the most or least tax. The bureau decided this particular case in accordance with what in its opinion was the correct legal view. This decision of the bureau on the question of law was subsequently upheld, over the strenuous objections of the stockholders who were taxed on the 1915 dividend, by the Supreme Court of the United States. The committee's representative, therefore, in criticizing the action of the bureau in this case sets up his judgment on a legal question not only against that of the Bureau of Internal Revenue but also against the decision on this precise question by the Supreme Court of the United States. His criticism does not in my opinion merit further consideration.

Sincerely yours,

(Signed) D. H. BLAIR,
Commissioner.

JUNE 22, 1925.

To: L. C. Manson, general counsel.
From: L. H. Parker, chief engineer.
System report No. 1.
Subject: Progress of Income Tax Unit in getting its work current.

Synopsis.—Attached hereto are the inventories of returns on hand in the Income Tax Unit as of March, 1923, as of March, 1924, and as of March, 1925, as taken by the unit (Exhibits B, C, and D). From an analysis of these figures it appears—

(*a*) That the Income Tax Unit is 30.4 per cent further behind with its work than it was two years ago.

(*b*) That the Income Tax Unit is 34.4 per cent further behind with its work than it was one year ago.

(*c*) That there appears to be no prospect of the unit getting its work current on the showing thus far made.

Analysis of inventories.—The inventories as taken by the unit and shown in Exhibits B, C, and D attached are not indicative of the progress of the unit without analysis. Progress is obviously only shown in a comparison of the status of cases in a certain year with the status in preceding years. Such a comparison not being set up by the unit, we have prepared a chart (Exhibit E), which gives the following information in comparative form for each of the three dates, March, 1923, March, 1924, and March, 1925:

(*a*) Returns five years old and older in each division with total in unit.
(*b*) Returns four years old in each division with total in unit.
(*c*) Returns three years old in each division with total in unit.

In the analysis of the inventories taken by the unit, in order to get a comparative picture of the returns on hand in the various divisions for each of the three years mentioned, we have been obliged to make certain new distributions from the original figures. For instance, the 1923 inventory shows certain returns in the special assignment section. This section having been abolished by the time the 1924 inventory was taken, it does not, of course, appear thereon. In this case, therefore, we have taken the personal returns, the corporation returns, and the consolidated returns on hand in the special assignment section in 1923, and distributed them to the respective divisions—i. e., to the personal audit division, to the corporation audit division, and to the consolidated returns audit division, as the case might require. We have handled in a similar way the natural resource audit division now abolished. We believe that the above distribution is perfectly fair, as the returns really belonged in the divisions designated, and employees of abolished sections would, of course, be available for transfer to the regular audit divisions, taking over their work. It is obvious that in getting at progress the basis of distribution for each year should be as nearly identical as possible.

As to the inventories covering the records division and the field, we have made the following assumption, which is distinctly to the advantage of the unit in showing progress. We have assumed the 1923 and 1924 inventories in the records division not to include returns in the field, and the 1925 inventory of cases in the records division we have assumed to include returns in the field. In this way it is certain that the unit is given credit for all the progress it can possibly have made, as any other method would increase the returns on hand in 1925 or decrease the returns on hand in 1923 and 1924.

It will be noted that the inventories do not take into account 1916 cases or those for prior years. We believe this can be accepted without criticism. While it is true there are a number of 1916 cases still pending, the actual work on these is negligible, as there is nothing but a straight 2 per cent tax for this year and no question of invested capital. The main reason for the existence of open 1916 returns lies in the fact that its determination may depend on some feature required for 1917 and 1918 and the whole matter is being considered together. For instance, a valuation may be under dispute which will fix the depletion for 1917 and 1918 and 1916 as well. While the main point of interest is the 1917 and 1918 depletion, it is nevertheless necessary to have the 1916 return consistent with the 1917 and 1918; hence it is kept open.

Referring again to Exhibit E, it will be seen that we have divided the returns on hand into the following groups:

(1) Personal audit division.
(2) Corporation audit division.
(3) Consolidated returns audit division.
(4) Special assessment section.
(5) Special adjustment section.
(6) Engineering division.
(7) Records division.
(8) Field.

We then show how many returns were in these divisions which were five years old and older as of March, 1923, as of March, 1924, and as of March, 1925. We consider a 1917 return to be five years old in March, 1923, as this return was due in the collector's office in March, 1918. These figures being opposite each other in three adjacent columns, they are readily comparable, as well as the totals of these columns. We have done the same thing with four-year-old returns and three-year-old returns.

We have not considered one-year-old or two-year-old returns, first because the one-year-old return we consider as current, and second because we have not the data in the inventory to properly handle the two-year-old return. We contend that the two-year-old return should not be considered a current return, but we have been obliged to treat it as such in the present report to the benefit of the bureau. For example, we think the bureau should be said to be current when its 1922 returns (due March, 1923) are completed by March, 1925. This allows two years to a return, but a 1922 return should not really be considered as current work on the March, 1925, inventory, as we have been compelled to treat it in this report.

We have also shown on chart (Exhibit E) certain percentages and totals, the meaning of which is self-evident from the chart. In Exhibit F we have shown detailed analysis of returns in the various divisions.

Discussion of results.—In order that we may be clearly understood, we wish to reiterate that this report deals with the matter of whether or not the Income Tax Unit is getting more current with its work. To illustrate what we mean, we will suppose a business has orders for 100,000 tons of steel I-beams in 1917 and the same amounts ordered in both 1918 and 1919. The plant turned out only 50,000 tons of beams in 1917, 80,000 in 1918, and 120,000 in 1919. Now the managers of the business would consider in this case that, while they turned out 30,000 tons more beams in 1918 than in 1917, nevertheless they were getting further behind with their work, as on December 31, 1917, they only had 50,000 tons of beams undelivered, while on December 31, 1918, they had 70,000 tons undelivered. In other words, they were going further behind instead of catching up with their overdue work. The first progress would be shown in 1919, when 20,000 tons decrease in overdue work would take place.

In exactly the same way we are measuring the work of the unit—the point is, are they catching up with their overdue work—regardless of annual output of current work. We believe that we are more than fair to the bureau in considering all returns 2 years old or less as current returns and all returns 3 years old or older as overdue returns. We contend that for ideal conditions in the unit a 1922 return should be closed by March, 1924, but, as before stated, we will consider in this report that returns overdue are 3 years old or older on account of incomplete information for 1922 returns in the records division.

The whole story is seen from the chart (Exhibit E attached).

First, as to the open returns five years old or older in the unit as a whole, we have on hand—

As of March, 1923—33,428 returns.
As of March, 1924—30,150 returns.
As of March, 1925—31,669 returns.

We deem this progress unsatisfactory on five-year-old returns, as only a net gain of 5 per cent is recorded in two years, at which rate it would take 40 years to get current.

Second, as to the open returns four years old in the unit as a whole, we have on hand—

As of March, 1923—112,664 returns.
As of March, 1924—93,270 returns.
As of March, 1925—109,082 returns.

We deem this progress unsatisfactory on four-year-old returns, as only a net gain of 3 per cent is recorded in two years, at which rate it would take 66 years to get current.

Third, as to the open returns three years old in the unit as a whole, we have on hand:

As of March, 1923—156,905.
As of March, 1924—170,622.
As of March, 1925—254,352.

We deem this showing to be highly unsatisfactory for three-year-old returns, as it shows a loss of 62 per cent in two years.

Fourth, all the open returns in the unit, 3 years old or older:

As of March, 1923, amount to 302,997.
As of March, 1924, amount to 294,042.
As of March, 1925, amount to 395,103.

We consider this showing highly unsatisfactory, as it shows a loss of ground of 30.4 per cent in two years.

In regard to the individual divisions, it is harder and more misleading to try to arrive at the progress on account of the holding in records division of returns and the distribution of same to other divisions as called for.

We believe that the best picture of the status of these divisions is obtained by a study of the 5-year-old or older returns on hand.

The personal audit division shows a gain on its five-year-old work, having reduced its returns by 1,253, or an improvement of 13 per cent. This might indicate that the decentralization of the work for returns over $25,000 has helped the division.

The corporation audit division shows a loss in progress on its five-year-old work, having 778 more returns on hand than two years previous, a loss in progress of 15 per cent.

The consolidated returns audit division shows a loss in progress on its five-year-old work, having on hand 2,552 more returns than two years previous, a loss of 113 per cent. The division appears to be in a very unsatisfactory condition.

The special assessment section shows a loss in progress on its five-year-old work, having on hand, 6,161 more returns than two years previous, a loss of 269 per cent. This is, of course, highly unsatisfactory, but we believe it is not entirely the fault of the section; it is due to a lot of taxpayers rushing in with special assessment claims when they could not get all they wanted under the regular provisions of the law.

The special adjustment section shows a loss in progress of 110 per cent in the last two years.

The engineering division shows a loss in progress on its five-year-old work, having on hand 1,318 more returns than two years ago, a loss of 207 per cent. We consider this division in unsatisfactory condition on its old work.

Conclusion.—We contend that the real test of the progress of the bureau is in its status in regard to its work on returns three years old or older. Inasmuch as we have shown that the bureau has 30.4 per cent more of such work on hand now than it did two years ago, we must conclude that the bureau is not catching up and getting current, but is getting further and further behind.

Respectfully submitted.

L. H. PARKER, *Chief Engineer.*

EXHIBIT B

Annual inventory, March, 1923

ALL CASES

	1917	1918	1919	1920	1921	1922	Total
Grand total: Unit	33,428	112,664	156,905	676,700	6,563	153	986,413
Personal audit division: Total	8,155	16,344	32,025	45,491	2,209	32	104,256
Section 1	535	716	1,108	6,613	123	0	9,104
Section 2	397	1,755	10,798	7,177	57	1	20,185
Section 3	672	1,578	4,774	8,390	150	3	15,567
Section 4	757	739	1,162	5,230	116	6	8,010
Section 5	1,465	833	1,465	5,111	106	2	8,982
Section 6	9[illegible]0	1,132	3,[illegible]	5,473	266		11,180
Section F. R	3,359	9,591	9,519	7,197	1,151	11	31,228
Corporation audit division: Total	2,240	17,051	25,293	32,721	2,969	86	80,366
Manufacturing	886	5,234	7,562	8,952	668	11	23,313
Trading	506	1,593	6,158	5,220	966	12	17,485
Finance	209	1,367	2,223	7,300	271	1	11,374
P. U. and P. S	293	1,052	5,543	4,512	575	10	11,985
Miscellaneous	346	1,808	3,807	6,737	489	22	13,209
Special audit division: Total	5,868	15,639	16,846	11,244	709	19	50,325
Adjustment	334	968	1,063	951	107	2	3,424
Amortization	95	1,371	1,134	563	46	1	3,210
Assignment	1,378	4,516	6,269	5,630	250	3	18,046
Assessment	2,229	3,958	3,787	2,346	190	9	12,519
Consolidated	1,833	4,826	4,593	1,751	116	4	13,126
Natural resources division: Total	3,928	10,534	12,946	8,796	676	13	36,893
Section F	2,634	6,514	7,298	4,639	236	1	21,322
Section G	544	891	929	649	79	4	3,096
Section H	208	299	279	180	7		973
Valuations	542	2,830	4,440	3,328	354	8	11,502
Records division (estimated). Total	2,043	24,263	46,654	568,316			641,273
Field. Total	11,194	28,830	28,144	10,132			78,300

Annual inventory, March, 1923—Continued

INDIVIDUAL CASES

	1917	1918	1919	1920	1921	1922	Total
Grand total: Unit	16,297	36,132	48,881	446,526	2,283	34	550,153
Personal audit division: Total	8,155	16,344	32,025	45,491	2,209	32	104,256
Section 1	535	716	1,108	6,613	123	0	9,104
Section 2	307	1,755	10,708	7,177	57	1	20,185
Section 3	672	1,578	4,774	8,390	150	3	15,567
Section 4	757	739	1,162	5,230	116	6	8,010
Section 5	1,465	833	1,465	5,111	106	2	8,982
Section 6	970	1,132	3,399	5,473	206	....	11,180
Section F. R.	3,359	9,591	9,319	7,497	1,451	11	31,228
Special audit division: Total	558	1,961	1,970	1,331	66	2	5,888
Adjustment	245	740	812	721	66	2	2,586
Amortization	6	175	126	47	....	....	354
Assessment	153	571	646	402	....	....	1,772
S. M.	154	463	377	159	....	....	1,153
C. R.	....	12	9	2	....	....	23
Natural resources division: Total	1,142	3,190	3,304	2,053	8	....	9,697
Section F.	1,085	3,124	3,251	2,009	7	....	9,476
Section G.	13	21	23	18	....	....	75
Section H.	44	45	30	26	1	....	146
Records division (estimated): Total	....	....	....	391,438	....	....	391,438
Field: Total	6,442	14,637	11,582	6,213	....	....	38,874

CORPORATION CASES

	1917	1918	1919	1920	1921	1922	Total
Grand total: Unit	14,333	70,263	100,515	221,085	4,093	111	410,400
Corporation audit division: Total	2,240	17,054	25,293	32,721	2,969	89	80,366
Manufacturing	886	5,234	7,562	8,952	668	11	23,313
Trading	506	4,593	6,158	5,220	966	42	17,485
Finance	209	1,367	2,223	7,300	271	4	11,374
P. U. and P. S.	293	4,052	5,543	4,512	575	10	14,985
Miscellaneous	346	1,808	3,807	6,737	480	22	13,200
Special audit division: Total	3,292	9,679	10,907	8,439	535	13	32,865
Adjustment	88	228	251	230	41	....	838
Amortization	89	1,196	1,008	516	46	1	2,856
A. S.	1,225	3,945	5,623	5,228	250	3	16,274
S. M.	1,792	3,209	3,240	2,110	190	9	10,640
C. R. B.	98	1,011	785	355	8	....	2,257
Natural resources division: Total	2,365	6,638	8,888	6,218	589	9	24,707
Section F.	1,549	3,390	4,047	2,630	229	1	11,846
Section G.	125	180	167	111	....	....	583
Section H.	149	238	234	149	6	....	776
Valuation	542	2,830	4,140	3,328	354	8	11,502
Records division (estimated): Total	1,784	23,410	44,583	170,000	....	....	239,777
Field: Total	4,652	13,482	10,844	3,707	....	....	32,685

Annual inventory, March, 1923—Continued

CONSOLIDATED CASES

	1917	1918	1919	1920	1921	1922	Total
Grand total: Unit	2,798	6,269	7,509	9,089	187	8	25,860
Special audit division: Total	2,018	3,999	3,969	1,474	108	4	11,572
Section A	165	539	504	203	15	3	1,429
Section B	365	640	653	234	15		1,907
Section C	47	424	438	146	18		1,073
Section D	576	927	911	327	14	1	2,756
Section E	504	1,175	1,188	433	43		3,343
R R	78	98	105	54	3		338
S. M	283	196	170	77			726
Natural resources division: Total	421	706	754	525	79	4	2,489
Section G	406	690	739	520	79	4	2,438
Section H	15	16	15	5			51
Records division: Total	259	853	2,068	6,878			10,058
Field: Total	100	711	718	212			1,741

CLAIMS AND R. A. R.'S

Divisions and sections	Claims	R. A. R.'s	Divisions and sections	Claims	R. A. R.'s
Grand total	61,079	56,868	Special audit	15,448	17,606
Personal audit and field review	12,412	16,500	Special assessment	3,871	3,915
			Special assignment	2,871	1,892
			Special adjustment	551	637
Corporation audit	8,252	5,661	Consolidated returns	7,022	10,835
			Amortization	1,133	327
Manufacturers	3,021	1,996			
Trading	2,469	1,883	Administration	16,279	10,111
Finance	820	300			
P. A. and P. S.	1,204	797	Claims control	13,612	
Miscellaneous	729	685	Sorting	1,273	
			Proving	1,394	
Natural resources	8,688	6,990	Field reports control		10,111
Audit F	7,598	6,138			
Audit G	1,090	852			

EXHIBIT C

Annual inventory, March, 1924

ALL CASES

	1917	1918	1919	1920	1921	1922	1923	Total
Grand total: Unit	10,490	19,660	93,270	170,622	303,624	887,311	1,262,746	2,747,723
Personal audit division: Total	3,331	5,067	12,337	22,290	7,704	2,091	10	52,830
Section 1	515	934	2,204	4,173	1,262	395	1	9,484
Section 2	826	1,030	2,807	5,753	1,918	331	2	12,667
Section 3	553	954	2,129	2,740	1,053	404		7,833
Section 4	682	859	1,987	4,991	887	329	7	9,022
Section 5	855	1,290	3,230	4,633	1,852	405		12,265
Section 6					732	227		959
Corporation audit division: Total	2,268	4,906	18,335	34,732	14,308	1,644	12	76,205
Section 21	400	750	3,983	7,282	2,831	299		15,545
Section 22	503	1,099	3,977	6,976	6,976	241	7	15,292
Section 23	463	1,147	3,769	7,300	3,450	407		16,536
Section 24	562	1,165	3,801	7,342	2,949	394	2	16,216
Section 25	340	747	2,802	5,832	2,589	303	3	12,616

Annual inventory, March, 1924—Continued

ALL CASES—Continued

	1917	1918	1919	1920	1921	1922	1923	Total
Consolidated audit division:								
Total	1,078	2,272	4,581	6,333	2,447	157		16,868
Section A	149	330	275	192	29	2		977
Section B	141	311	541	644	208	28		1,873
Section C	165	371	704	683	187	17		2,127
Section D	231	505	605	448	136	29		1,954
Section E	234	493	839	603	163	36		2,368
Railroads	113	129	246	278	94	2		862
Adm	45	133	1,371	3,485	1,630	43		16,707
Natural resources:								
Total	1,516	2,892	13,380	13,411	1,853	282		33,334
Section F	1,044	2,247	12,451	12,402	1,650	247		30,011
Section G	366	545	795	884	188	34		2,812
Section H	106	130	134	125	15	1		511
Engineering division: Total	454	761	2,836	4,250	1,902	1,102		11,395
Special assessment section: Total	1,077	1,938	2,144	2,806	372	20		8,357
Special adjustment section: Total	193	336	587	560	425	89		2,195
Records division: Total	456	1,026	2,952	9,573	268,480	881,560	1,262,719	2,426,766
Field: Total	112	462	36,118	76,667	6,043	366	5	119,773

INDIVIDUAL CASES

	1917	1918	1919	1920	1921	1922	1923	Total
Grand total: Unit	4,241	6,847	52,793	73,032	78,006	620,372	892,678	1,627,949
Personal audit division:								
Total	3,331	5,067	12,337	22,290	7,704	2,091	10	52,830
Section 1	515	934	2,204	4,173	1,262	395	1	9,484
Section 2	826	1,030	2,807	5,753	1,918	331	2	12,667
Section 3	553	954	2,129	2,740	1,053	404		7,833
Section 4	582	859	1,967	4,991	887	329	7	9,622
Section 5	855	1,290	3,230	4,633	1,852	405		12,265
Section 6					732	227		959
Natural resources audit division								
Total	483	1,263	6,302	5,507	982	192		14,729
Section F	460	1,253	6,286	5,490	980	192		14,661
Section G	15	8	14	14	2			53
Section H	8	2	2	3				15
Special assessment section	195	53	40	19	2			309
Special adjustment section	141	236	410	387	285	74		1,533
Records division (estimated)					66,251	517,757	892,666	1,476,674
Field	71	226	33,704	44,829	2,782	258	2	81,874

Annual inventory, March, 1924—Continued

CORPORATION CASES

	1917	1918	1919	1920	1921	1922	1923	Total
Grand total: Unit	5,173	10,635	36,609	93,055	216,228	366,830	370,068	1,099,658
Corporation audit division: Total	2,268	4,906	18,335	34,732	14,308	1,644	12	76,205
Section 21	400	750	3,083	7,282	2,831	200		15,545
Section 22	503	1,009	3,977	6,976	2,489	241	7	15,202
Section 23	463	1,147	3,769	7,300	3,450	407		16,536
Section 24	562	1,163	3,804	7,342	2,946	394	2	16,216
Section 25	340	747	2,802	5,832	2,589	303	3	12,616
Natural resources audit division: Total	755	1,169	6,410	7,142	713	57		16,246
Section F	584	964	6,165	6,912	670	55		15,350
Section G	88	94	139	134	31	1		487
Section H	83	111	106	96	12	1		409
Consolidated returns audit division: Total	409	825	1,980	3,001	1,106	81		7,402
Section A	48	114	80	55	6			312
Section B	46	107	216	244	85	15		713
Section C	73	162	302	245	54	8		844
Section D	90	180	210	185	44	14		723
Section E	74	150	224	160	91	10		659
Railroads	60	58	127	124	47	1		417
Administration	18	54	812	1,988	829	33		3,734
Engineering division	454	761	2,836	4,250	1,902	1,162		11,395
Special assessment section	750	1,682	1,974	2,728	348	20		7,502
Special adjustment section	57	100	177	173	140	15		662
Records division	456	1,026	2,952	9,573	194,471	363,803	370,053	942,334
Field	24	166	2,035	31,456	3,150	108	3	36,942

CONSOLIDATED CASES

	1917	1918	1919	1920	1921	1922	1923	Total
Grand total: Unit	1,096	2,178	3,779	4,535	9,390	109		21,086
Consolidated returns, audit division: Total	669	1,447	2,601	3,332	1,341	76		9,466
Section A	101	216	186	137	23	2		665
Section B	95	204	325	400	123	13		1,160
Section C	92	209	402	438	133	9		1,283
Section D	141	325	395	263	92	15		1,231
Section E	160	343	615	143	122	26		1,709
Rr.	53	71	119	154	47	1		445
Adm.	27	79	559	1,497	801	10		2,973
Natural resources, audit division: Total	278	460	668	762	158	33		2,359
Section G	263	443	642	736	155	33		2,272
Section H	15	17	26	26	3			87
Special assessment section	132	203	130	59	22			546
Records division					7,758			7,758
Field	17	68	379	382	111			957

Annual inventory, March, 1924—Continued

CLAIMS AND R. A. R's

Divisions and sections	Claims	R. A. R's	Divisions and sections	Claims	R. A. R's
Grand total	68,041	45,468	Consolidated returns and special sections	10,085	14,698
Personal audit division	8,375	13,214	Consolidated returns	5,985	11,794
Corporation audit division	7,808	6,780	Special assessment	3,787	2,308
Manufacturers	1,443	1,202	Special adjustment	313	596
Trading	2,073	1,397	Records division	34,153	6,277
Furnace	1,840	1,504			
P. U. and P. S.	1,453	1,649			
Miscellaneous	999	938			
Natural resources audit division	7,620	4,499			
Audit F	6,305	3,701			
Audit G	1,315	798			

Exhibit D

Inventory March 16, 1925

GRAND TOTAL

	1917	1918	1919	1920	1921	1922	1923	Total	Claims	R. A. R.'s
Total	4,919	9,101	17,649	109,082	254,352	23,477	7,173	425,753	41,940	42,493
Individual	1,532	2,687	6,562	60,748	116,628	11,294	3,948	203,399	17,603	22,948
Corporation	2,674	5,186	9,382	42,117	129,917	11,472	3,108	203,856	19,246	15,792
Consolidated	713	1,228	1,705	6,217	7,807	711	117	18,498	5,091	3,753
Unassigned and in process: Total	1,260	2,827	6,545	90,411	236,942	18,214	5,371	361,570	....	....
Individual	259	532	1,575	49,088	104,635	7,483	2,428	166,000	....	....
Corporation	959	1,969	4,341	35,848	124,810	10,052	2,832	180,711	....	....
Consolidated	42	326	629	5,475	7,497	679	111	14,859	....	....
274 file: Total	779	1,580	3,274	7,844	9,327	2,698	1,106	26,609	....	....
Individual	194	426	1,233	4,450	6,380	2,004	990	15,657	....	....
Corporation	493	1,007	1,812	2,980	2,756	676	111	9,875	....	....
Consolidated	92	147	229	394	192	18	5	1,077	....	....
Protest: Total	2,880	4,694	7,830	10,827	8,082	2,565	696	37,574	....	....
Individual	1,079	1,729	3,784	7,200	5,613	1,807	530	21,742	....	....
Corporation	1,322	2,210	3,199	3,279	2,351	744	165	13,270	....	....
Consolidated	179	755	847	348	118	11	1	2,562	....	....

Inventory March 16, 1925—Continued.

INDIVIDUAL CASES—GRAND TOTAL

	1917	1918	1919	1920	1921	1922	1923	Total	Claims	R. A. R.'s
Total	1,532	2,687	6,562	60,748	116,628	11,224	3,948	203,399	17,603	22,948
Personal	1,162	2,004	5,031	16,784	19,675	10,095	3,254	58,005	4,763	17,329
Corporation	40	184	404	889	1,088	113	23	2,741	527	451
Engineering	63	122	349	1,053	1,352	911	619	4,469	367	955
Special assessment	182	86	135	91	23			517		
Special adjustment	85	165	278	329	261	175	52	1,345	237	648
Records		126	365	41,602	94,220			136,322	11,700	3,585
Unassigned and in process: Total	259	532	1,575	49,088	104,635	7,483	2,428	166,000		
Personal	86	232	758	5,965	8,138	6,439	1,759	23,377		
Corporation	6	27	174	652	922	85	11	1,877		
Engineering	3	11	60	635	1,206	868	615	3,398		
Special assessment	136	69	105	82	22			414		
Special adjustment	28	67	113	152	118	91	43	612		
Records		126	365	41,602	94,220			136,322		
274 file: Total	194	426	1,203	4,460	6,380	2,004	990	15,657		
Personal	158	372	1,094	4,314	6,262	1,962	976	15,138		
Corporation	3	24	58	109	96	17	11	318		
Special assessment	22	14	27	9	1			73		
Special adjustment	11	16	24	28	21	25	3	128		
Protest: Total	1,079	1,729	3,784	7,200	5,613	1,807	530	21,742		
Personal	918	1,400	3,179	6,505	5,275	1,694	519	19,490		
Corporation	31	133	172	128	70	11	1	546		
Engineering	60	111	289	418	146	43	4	1,071		
Special assessment	24	3	3					30		
Special adjustment	46	82	141	149	122	59	6	605		
Division total	1,162	2,004	5,031	16,784	19,675	10,095	3,254	58,005	4,763	17,329
Section 1	229	497	1,067	3,846	5,168	2,753	917	14,477	1,197	4,468
Section 2	318	341	1,002	3,997	4,088	1,931	667	12,344	1,024	4,591
Section 3	175	389	1,012	2,949	3,872	2,741	671	11,809	815	2,885
Section 4	183	327	876	2,592	2,527	1,059	450	8,014	919	2,370
Section 5	257	450	1,074	3,400	4,020	1,620	540	11,361	808	3,015
Unassigned and in process: Total	86	232	758	5,965	8,138	6,439	1,759	23,377		
Section 1	23	67	146	1,504	2,094	1,935	505	6,274		
Section 2	4	48	116	1,122	1,858	1,240	421	4,779		
Section 3	12	60	186	1,000	1,308	1,801	302	4,669		
Section 4	14	40	100	857	973	415	234	2,642		
Section 5	33	47	201	1,482	1,905	1,048	297	5,013		
274 file: Total	158	372	1,094	4,314	6,262	1,962	976	15,138		
Section 1	25	76	204	1,054	1,770	438	266	3,833		
Section 2	41	69	244	826	1,186	430	170	2,966		
Section 3	31	90	258	971	1,467	548	250	3,615		
Section 4	26	48	196	704	757	288	132	2,151		
Section 5	35	89	192	759	1,082	258	158	2,573		
Protest: Total	918	1,400	3,179	6,505	5,275	1,694	519	19,490		
Section 1	181	354	717	1,288	1,304	380	146	4,370		
Section 2	273	251	642	2,049	1,044	261	76	4,596		
Section 3	132	239	568	978	1,097	392	119	3,525		
Section 4	143	239	571	1,031	797	347	93	3,221		
Section 5	189	314	681	1,159	1,033	134	85	3,775		

Inventory March 16, 1925—Continued

INDIVIDUAL CASES—CORPORATION AUDIT DIVISION

	1917	1918	1919	1920	1921	1922	1923	Total	Claims	R. A. R.'s
Division total	40	184	404	889	1,088	113	23	2,741	527	431
Section 21	16	61	108	288	314	30	4	821	142	135
Section 22	11	87	153	282	476	23	3	1,035	235	102
Section 23	5	6	28	81	85	13	1	219	25	48
Section 24	6	17	64	150	126	39	10	412	65	92
Section 25	2	13	51	88	87	8	5	254	60	54
Unassigned and in process:										
Total	6	27	174	652	922	85	11	1,877		
Section 21	4	24	54	212	256	25	2	577		
Section 22			82	243	456	20	3	804		
Section 23		1	15	55	58	8		137		
Section 24				83	94	30	4	211		
Section 25	2	2	23	59	58	2	2	148		
274 file:										
Total	3	24	58	109	96	17	11	318		
Section 21		6	26	45	37	4	1	119		
Section 22		7	14	13	7	1		42		
Section 23	3	2	8	14	20	2	1	50		
Section 24		8	3	19	14	5	6	55		
Section 25		1	7	18	18	5	3	52		
Protest:										
Total	31	133	172	128	70	11	1	546		
Section 21	12	31	28	31	21	1	1	125		
Section 22	11	80	57	26	13	2		189		
Section 23	2	3	5	12	7	3		32		
Section 24	6	9	61	48	18	4		146		
Section 25		10	21	11	11	1		54		

INDIVIDUAL CASES—ENGINEERING DIVISION

	1917	1918	1919	1920	1921	1922	1923	Total	Claims	R. A. R.'s
Division total	63	122	349	1,053	1,352	911	619	4,469	367	955
Oil and gas	36	57	231	735	1,050	737	474	3,320	216	707
Timber	12	14	37	53	31	14	4	165	42	87
Coal	5	7	25	142	143	91	52	465	34	94
Appraisal	3	30	25	12	5	1		76	40	31
Metals	5	12	24	85	86	45	70	327	26	24
Nonmetals	2	2	7	26	37	23	19	116	9	12
Unassigned and in process:										
Total	3	11	60	635	1,206	868	615	3,398		
Oil and gas	3	8	40	433	935	697	470	2,586		
Timber			5	40	28	14	4	91		
Coal		1	5	85	126	88	52	357		
Appraisal		2	8	3	2	1		16		
Metals			2	59	80	45	70	256		
Nonmetals				15	35	23	19	92		
Protest:										
Total	60	111	289	418	146	43	4	1,071		
Oil and gas	33	49	191	302	115	40	4	734		
Timber	12	14	32	13	3			74		
Coal	5	6	20	57	17	3		108		
Appraisal	3	28	17	9	3			60		
Metals	5	12	22	26	6			71		
Nonmetals	2	2	7	11	2			24		

Inventory March 16, 1925—Continued

INDIVIDUAL CASES—SPECIAL ADJUSTMENT SECTION

	1917	1918	1919	1920	1921	1922	1923	Total	Claims	R. A. R.'s
Section total	85	165	278	329	261	175	52	1,345	237	648
Unassigned and in process	28	67	113	152	118	91	43	612		
274 file	11	16	24	28	21	25	3	128		
Protest	46	82	141	149	122	59	6	605		

INDIVIDUAL CASES—SPECIAL ASSESSMENT SECTION

	1917	1918	1919	1920	1921	1922	1923	Total	Claims	R. A. R.'s
Section total	182	86	135	91	23			517		
Unassigned and in process	136	69	105	82	22			414		
274 file	22	14	27	9	1			73		
Protest	24	3	3					30		

CORPORATION CASES—GRAND TOTAL

	1917	1918	1919	1920	1921	1922	1923	Total	Claims	R. A. R.'s
Total	2,674	5,186	9,382	42,117	129,917	11,472	3,108	203,856	19,246	15,792
Corporation	853	1,432	3,151	9,476	11,828	4,161	1,057	31,958	4,894	6,996
Consolidated	469	701	1,005	3,400	3,596	6,691	1,912	17,774	1,505	1,721
Special assessment	1,164	2,431	3,805	3,723	1,052	160		12,335	6,792	3,459
Special adjustment	29	59	85	104	96	54	12	439		
Affiliated	8	41	65	335	819	231	10	1,509	78	166
Engineering	151	244	484	705	589	175	117	2,465	623	575
Recording		278	787	24,374	111,937			137,376	5,354	2,875
Unassigned and in process:										
Total	859	1,969	4,341	35,848	124,810	10,052	2,832	180,711		
Corporation	9	24	254	4,168	7,057	2,796	800	15,108		
Consolidated	66	146	396	2,918	3,410	6,671	1,898	15,505		
Special assessment	772	1,471	2,738	3,588	1,020	156		9,745		
Special adjustment	10	22	35	50	50	33	7	207		
Affiliated	1	12	11	311	809	229	10	1,383		
Engineering	1	16	120	439	527	167	117	1,387		
Recording		278	787	24,374	111,937			137,376		
274 file:										
Total	493	1,007	1,842	2,090	2,756	676	111	9,875		
Corporation	207	375	847	2,599	2,602	651	106	7,387		
Consolidated	49	93	168	296	124	17	3	750		
Special assessment	235	535	819	87	22	2		1,700		
Special adjustment	2	4	8	8	8	6	2	38		
Protest:										
Total	1,322	2,210	3,199	3,279	2,351	744	165	13,270		
Corporation	637	1,033	2,050	2,709	2,169	714	151	9,463		
Consolidated	354	462	441	186	62	3	11	1,519		
Special assessment	157	425	248	48	10	2		890		
Special adjustment	17	33	42	46	38	15	3	194		
Affiliated	7	29	54	24	10	2		126		
Engineering	150	228	364	266	62	8		1,078		

Inventory March 16, 1925—Continued

CORPORATION CASES—CORPORATION AUDIT DIVISION

	1917	1918	1919	1920	1921	1922	1923	Total	Claims	R. A. R.'s
Division total	853	1,432	3,151	9,476	11,828	4,161	1,057	31,958	4,894	6,996
Section 21	175	269	597	1,833	2,880	732	219	6,205	971	1,324
Section 22	198	835	761	2,539	3,285	1,361	827	8,806	1,478	2,038
Section 23	181	299	637	2,037	1,935	516	132	5,737	936	1,472
Section 24	155	265	586	1,718	2,304	804	174	6,009	903	1,249
Section 25	144	264	567	1,349	1,924	748	205	5,201	611	913
Unassigned and in process:										
Total	9	24	254	4,168	7,057	2,796	780	15,108		
Section 21	1	1	68	815	1,385	500	174	2,944		
Section 22	2	2	75	1,364	2,163	1,060	276	4,942		
Section 23	6	21	67	801	1,012	298	93	2,298		
Section 24			26	773	1,466	490	105	2,860		
Section 25			18	415	1,031	448	152	2,064		
274 file:										
Total	207	375	847	2,599	2,602	651	106	7,387		
Section 21	46	73	149	505	567	114	22	1,476		
Section 22	46	77	173	530	567	141	19	1,553		
Section 23	37	65	169	685	572	132	17	1,677		
Section 24	34	64	159	410	393	117	25	1,202		
Section 25	44	96	197	469	503	147	23	1,479		
Protest:										
Total	637	1,033	2,050	2,709	2,160	714	151	9,463		
Section 21	128	195	380	513	428	118	23	1,785		
Section 22	150	256	513	645	555	160	32	2,311		
Section 23	138	213	401	551	351	86	22	1,762		
Section 24	121	201	404	535	445	197	44	1,947		
Section 25	100	168	352	465	390	153	30	1,658		

CORPORATION CASES—CONSOLIDATED RETURNS DIVISION

	1917	1918	1919	1920	1921	1922	1923	Total	Claims	R. A. R.'s
Division total	469	701	1,005	3,400	3,596	6,691	1,912	17,774	1,505	1,721
Ad	12	13	34	1,842	2,585	6,543	1,865	12,894	638	361
A	51	103	130	281	152	19	2	738	184	442
C	89	104	151	269	171	20	3	807	176	252
D	90	164	253	387	244	14	4	1,156	212	343
E	56	125	204	362	262	61	24	1,094	172	312
G	146	134	153	129	72	13		647		
RR	25	58	80	130	110	21	14	438	123	11
Assigned and in process:										
Total	66	146	396	2,918	3,410	6,671	1,898	15,505		
Ad	12	13	34	1,842	2,585	6,543	1,865	12,894		
A	9	35	57	173	109	11	1	395		
C	5	16	63	193	147	16	2	442		
D	7	18	52	254	195	13	4	543		
E	1	33	81	250	214	56	13	648		
G	26	25	70	101	64	11		297		
RR	6	6	39	105	96	21	13	286		
274 file:										
Total	49	93	168	296	124	17	3	750		
A	5	8	16	75	35	8	1	148		
C	10	13	29	41	14	2		109		
D	5	35	73	92	31	1		237		
E	22	19	24	75	37	5	1	183		
G	6	14	19	9	6	1		55		
RR	1	4	7	4	1		1	18		
Protest:										
Total	354	462	441	186	62	3	11	1,519		
A	37	60	57	33	8			195		
C	74	75	59	35	10	2	1	256		
D	78	111	128	41	18			376		
E	33	73	99	37	11		10	263		
G	114	95	64	19	2	1		295		
RR	18	48	34	21	13			134		

Inventory March 16, 1925—Continued

CORPORATION CASES—AFFILIATIONS SECTIONS

	1917	1918	1919	1920	1921	1922	1923	Total	Claims	R. A. R.'s
Section total	8	41	65	335	819	231	10	1,509	78	166
Unassigned and in process	1	12	11	311	809	229	10	1,383		
Protest	7	29	54	24	10	2		126		

CORPORATION CASES—SPECIAL ASSESSMENT SECTION

	1917	1918	1919	1920	1921	1922	1923	Total	Claims	R. A. R.'s
Section total	1,164	2,431	3,805	3,723	1,052	160		12,335	6,792	3,459
Unassigned and in process	772	1,471	2,738	3,588	1,020	156		9,745		
274 File	235	535	819	87	22	2		1,700		
Protest	157	425	248	48	10	2		890		

CORPORATION CASES—SPECIAL ADJUSTMENT SECTION

	1917	1918	1919	1920	1921	1922	1923	Total	Claims	R. A. R.'s
Section total	29	59	85	104	96	54	12	439		
Unassigned and in process	10	22	35	50	50	33	7	207		
274 file	2	4	8	8	8	6	2	38		
Protest	17	33	42	46	38	15	3	194		

CORPORATION CASES—ENGINEERING DIVISION

	1917	1918	1919	1920	1921	1922	1923	Total	Claims	R. A. R.'s
Division total	161	244	484	705	589	175	117	2,465	623	575
Oil and gas	30	29	92	127	137	36	20	471	83	84
Timber	54	60	162	208	104	30	4	622	185	186
Coal	9	15	42	166	150	67	61	510	34	104
Appraisal	46	125	122	76	26	6	1	402	265	146
Metals	6	7	35	66	68	13	24	219	22	16
Nonmetals	6	8	31	62	104	23	7	241	34	39
Unassigned and in progress: Total	1	16	120	439	527	167	117	1,387		
Oil and gas	1	2	31	69	120	31	20	274		
Timber			34	150	97	30	4	315		
Coal		1	3	89	129	65	61	348		
Appraisal		13	38	46	20	6	1	124		
Metals			10	44	64	13	24	155		
Nonmetals			4	41	97	22	7	171		
Protest: Total	160	228	364	266	62	8		1,078		
Oil and gas	29	27	61	58	17	5		197		
Timber	54	60	128	58	7			307		
Coal	9	14	39	77	21	2		162		
Appraisal	46	112	84	30	6			278		
Metals	6	7	25	22	4			64		
Nonmetals	6	8	27	21	7	1		70		

Inventory March 16, 1925—Continued

CONSOLIDATED RETURNS—GRAND TOTAL

	1917	1918	1919	1920	1921	1922	1923	Total	Claims	R. A. R.'s
Total	713	1,228	1,705	6,217	7,807	711	117	18,498	5,091	3,753
Consolidated	478	770	1,222	5,714	6,318	616	101	15,219	4,349	3,323
Engineering	102	208	232	155	74	15	7	793	644	319
Special assessment	121	235	231	113	36	5		741		
Affiliations	12	15	20	235	1,379	75	9	1,745	98	111
Unassigned and in process: Total	142	326	629	5,475	7,497	679	111	14,859		
Consolidated	43	128	363	5,034	6,022	587	95	12,272		
Engineering	2	22	86	115	68	14	7	314		
Special assessment	97	173	177	100	34	3		584		
Affiliations		3	3	226	1,373	75	9	1,689		
274 file: Total	92	147	229	394	192	18	5	1,077		
Consolidated	80	112	191	386	192	18	5	984		
Special assessment	12	35	38	8				93		
Protest: Total	479	755	847	348	118	14	1	2,562		
Consolidated	355	530	668	294	104	11	1	1,963		
Engineering	100	186	146	40	6	1		479		
Special assessment	12	27	16	5	2	2		64		
Affiliations	12	12	17	9	6			56		

CONSOLIDATED CASES—CONSOLIDATED RETURNS DIVISION

	1917	1918	1919	1920	1921	1922	1923	Total	Claims	R. A. R.'s
Division total	478	770	1,222	5,714	6,318	616	101	15,219	4,349	3,323
Ad	9	22	41	3,833	5,042	500	71	9,518	831	450
A	56	106	173	388	286	25	7	1,041	715	684
C	41	88	135	337	260	9	2	872	299	376
D	104	166	298	381	239	22	4	1,214	739	609
E	75	126	207	384	270	28	6	1,096	542	479
G	163	205	300	259	120	17	2	1,066	928	697
RR	30	57	68	132	101	15	9	412	295	28
Unassigned and in process: Total	43	128	363	5,034	6,022	587	95	12,272		
Ad	9	22	41	3,833	5,042	500	71	9,518		
A	4	19	54	220	197	15	4	513		
C	3	6	32	211	203	3	1	459		
D	11	31	62	231	167	17	4	523		
E	3	17	47	227	206	23	5	528		
G	13	32	100	200	112	16	2	475		
RR		1	27	112	95	13	8	256		
274 file: Total	80	112	191	386	192	18	5	984		
A	9	15	26	116	69	8	3	246		
C	5	13	27	73	32	3		154		
D	16	26	60	87	48	3		240		
E	16	20	24	88	39	3		190		
G	31	33	48	17	3			132		
RR	3	5	6	5	1	1	1	22		
Protest: Total	355	530	668	294	104	11	1	1,963		
A	43	72	93	52	20	2		282		
C	33	69	76	53	25	3		259		
D	77	109	176	63	24	2		451		
E	56	89	136	69	25	2	1	378		
G	119	140	152	42	5	1		459		
RR	27	51	35	15	5	1		134		

Inventory March 16, 1925—Continued

CONSOLIDATED CASES—AFFILIATIONS SECTION

	1917	1918	1919	1920	1921	1922	1923	Total	Claims	R. A. R.'s
Section total	12	15	20	235	1,379	75	9	1,745	98	111
Unassigned and in process	......	3	3	226	1,373	75	9	1,689	....	......
Protest	12	12	17	9	6	....	......	56	....	......

CONSOLIDATED CASES—SPECIAL ASSESSMENT SECTION

	1917	1918	1919	1920	1921	1922	1923	Total	Claims	R. A. R.'s
Section total	121	235	231	113	36	5	......	741	....	......
Unassigned and in process	97	173	177	100	34	3	......	584	....	......
274 file	12	35	38	8	....	....	......	93	....	......
Protest	12	27	16	5	2	2	......	64	....	......

CONSOLIDATED CASES—ENGINEERING DIVISION

	1917	1918	1919	1920	1921	1922	1923	Total	Claims	R. A. R.'s
Division total	102	208	232	155	74	15	7	793	644	319
Oil and gas	15	15	28	17	11	3	3	92	72	34
Timber	26	29	42	36	18	2	1	154	83	84
Coal	4	5	8	20	11	1	......	49	11	20
Appraisal	50	151	140	72	18	6	2	439	454	160
Metals	2	3	11	5	10	2	1	34	18	14
Nonmetals	5	5	3	5	6	1	......	25	6	7
Unassigned and in process: Total	2	22	86	115	68	14	7	314	....	......
Oil and gas	2	7	21	14	11	3	3	61	....	......
Timber	......	1	14	28	16	2	1	62	....	......
Coal	......	......	1	13	8	......	......	22	....	......
Appraisal	......	14	46	51	.17	6	2	136	....	......
Metals	......	......	4	5	10	2	1	22	....	......
Nonmetals	......	......	......	4	6	1	......	11	....	......
Protests: Total	100	186	146	40	6	1	......	479	....	......
Oil and gas	13	8	7	3	....	....	......	31	....	......
Timber	26	28	28	8	2	....	......	92	....	......
Coal	4	5	7	7	2	1	......	27	....	......
Appraisal	50	137	94	21	1	....	......	303	....	......
Metals	2	3	7	....	....	....	......	12	....	......
Nonmetals	5	5	3	1	....	....	......	14	....	......

EXHIBIT E

Summary of open returns on hand

[Classified by age]

	March, 1923, returns 5 years old or older	March, 1924, returns 5 years old or older	March, 1925, returns 5 years old or older	March, 1923, returns 4 years old	March, 1924, returns 4 years old	March, 1925, returns 4 years old	March, 1923, returns 3 years old	March, 1924, returns 3 years old	March, 1925, returns 3 years old
Personal audit division	9,450	10,144	8,197	20,105	18,639	16,784	35,975	27,797	19,675
Corporation audit division	5,288	9,098	6,064	24,807	24,745	10,365	35,364	41,874	12,916
Consolidated returns audit division	2,254	4,088	4,806	5,532	5,249	9,684	5,347	7,095	12,112
Special assessment section	2,229	3,015	8,390	3,958	2,144	3,927	3,787	2,806	1,111
Special adjustment section	333	534	701	968	587	433	1,063	560	357
Engineering division	637	1,215	1,955	4,201	2,836	1,913	5,574	4,250	2,015
Records division	2,043	1,482	1,556	24,263	2,952	65,976	46,651	9,573	206,166
Total	22,234	29,576	31,669	83,834	57,152	109,082	133,761	93,955	254,352
In field	11,194	574	(1)	28,830	36,118	(1)	23,144	76,667	(1)
Grand total	33,428	30,150	31,669	112,664	93,270	109,082	156,905	170,622	254,352

[1] Included in records division.

Total returns 3 years old or older on hand—		
March, 1923		302,997
March, 1924		294,042
March, 1925		395,103
Total gain in getting current 1923 to 1924	per cent	2.6
Total loss in getting current 1924 to 1925	do	34.4
Total loss in getting current in 2 years (1923 to 1925)	do	30.4

EXHIBIT F

PERSONAL AUDIT DIVISION

	Year	March, 1923	Year	March, 1924	Year	March, 1925
7-year-old cases					1917	1,162
6-year-old cases			1917	3,814	1918	2,005
5-year-old cases	1917	9,480	1918	6,330	1919	5,031
4-year-old cases	1918	20,105	1919	18,639	1920	16,784
3-year-old cases	1919	35,975	1920	27,797	1921	19,675
2-year-old cases	1920	47,946	1921	8,686	1922	10,095
1-year-old cases	1921	2,217	1922	2,283	1923	3,254
Current cases	1922	32	1923	10	1924	
Total		115,755		67,559		58,006

CONSOLIDATED RETURNS AUDIT DIVISION

	Year	March, 1923	Year	March, 1924	Year	March, 1925
7-year-old cases					1917	967
6-year-old cases			1917	1,356	1918	1,527
5-year-old cases	1917	2,254	1918	2,732	1919	2,312
4-year-old cases	1918	5,532	1919	5,249	1920	9,584
3-year-old cases	1919	5,347	1920	7,095	1921	12,112
2-year-old cases	1920	2,279	1921	2,605	1922	7,613
1-year-old cases	1921	195	1922	190	1923	2,032
Current cases	1922	8	1923		1924	
Total		15,615		19,227		36,147

CORPORATION AUDIT DIVISION

	Year	March, 1923	Year	March, 1924	Year	March, 1925
7-year-old cases					1917	893
6-year-old cases			1917	3,023	1918	1,616
5-year-old cases	1917	5,288	1918	6,075	1919	3,555
4-year-old cases	1918	24,807	1919	24,745	1920	10,365
3-year-old cases	1919	35,264	1920	41,874	1921	12,916
2-year-old cases	1920	49,839	1921	15,021	1922	4,274
1-year-old cases	1921	3,454	1922	1,701	1923	1,080
Current cases	1022	93	1923	12	1924	
Total		119,745		92,451		34,699

SPECIAL ASSESSMENT SECTION

	Year	March, 1923	Year	March, 1924	Year	March, 1925
7-year-old cases					1917	1,467
6-year-old cases			1917	1,077	1918	2,752
5-year-old cases	1917	2,220	1918	1,938	1919	4,171
4-year-old cases	1918	3,958	1919	2,144	1920	3,927
3-year-old cases	1919	3,787	1920	2,806	1921	1,111
2-year-old cases	1920	2,346	1921	372	1922	165
1-year-old cases	1921	190	1922	20	1923	
Current cases	1922	9	1923		1924	
Total		12,510		8,357		13,593

SPECIAL-ADJUSTMENT SECTION

	Year	March, 1923	Year	March, 1924	Year	March, 1925
7-year-old cases					1917	114
6-year-old cases			1917	198	1918	224
5-year-old cases	1917	333	1918	336	1919	383
4-year-old cases	1918	968	1919	587	1920	433
3-year-old cases	1919	1,063	1920	560	1921	357
2-year-old cases	1920	951	1921	425	1922	279
1-year-old cases	1921	107	1922	89	1923	64
Current cases	1922	2	1923		1924	
Total		3,424		2,195		1,784

ENGINEERING DIVISION

	Year	March, 1923	Year	March, 1924	Year	March, 1925
7-year-old cases					1917	316
6-year-old cases			1917	454	1918	574
5-year-old cases	1917	637	1918	761	1919	1,065
4-year-old cases	1918	4,201	1919	2,836	1920	1,913
3-year-old cases	1919	5,574	1920	4,250	1921	2,015
2-year-old cases	1920	3,891	1921	1,992	1922	1,101
1-year-old cases	1921	400	1922	1,102	1923	743
Current cases	1922	9	1923		1924	
Total		14,712		11,395		7,727

RECORDS DIVISION

	Year	March, 1923	Year	March, 1924	Year	March, 1925
7-year-old cases					1917	
6-year-old cases			1917	456	1918	404
5-year-old cases	1917	2,043	1918	1,026	1919	1,152
4-year-old cases	1918	24,263	1919	2,952	1920	65,976
3-year-old cases	1919	46,651	1920	9,573	1921	206,166
2-year-old cases	1920	568,316	1921	268,480	1922	
1-year-old case	1921		1922	881,560	1923	
Current cases	1922		1923	1,262,719	1924	
Total		641,273		2,426,766		273,698

FIELD

	Year	March, 1923	Year	March, 1924	Year	March, 1925
7-year-old cases					1917	
6-year-old cases			1917	112	1918	
5-year-old cases	1917	11,194	1918	462	1919	
4-year-old cases	1918	28,830	1919	36,118	1920	
3-year-old cases	1919	23,144	1920	76,667	1921	
2-year-old cases	1920	10,132	1921	6,043	1922	
1-year-old case	1921		1922	306	1923	
Current cases	1922		1923	5	1924	
Total		73,300		119,773		

CLAIMS ON HAND

	March, 1923	March, 1924	March, 1925
Personal Audit Division	12,412	8,375	4,763
Corporation Audit Division	8,252	7,808	5,421
Consolidated return, Audit Division	9,893	5,985	6,030
Special assessment	3,871	3,787	6,792
Special adjustment	551	313	237
Engineering Division	9,821	7,620	1,631
Records Division	16,279	34,153	17,063
Total	61,079	68,041	41,940

JAMES COUZENS.
A. A. JONES.
WILLIAM H. KING.

69TH CONGRESS } SENATE { REPORT 27
1st Session } { Part 3

INVESTIGATION OF THE BUREAU OF INTERNAL REVENUE

FEBRUARY 1 (calendar day FEBRUARY 6), 1926. Ordered to be printed

Mr. ERNST, from the Select Committee on the Investigation of the Bureau of Internal Revenue, submitted the following

MINORITY VIEWS

[To accompany S. Res. 168, Sixty-eighth Congress]

On January 12, 1926, Mr. Couzens, from the select committee of which he is chairman, presented to the Finance Committee a 243-page majority report representing the results of the activities of this committee in investigating the Bureau of Internal Revenue. On the same day this majority report was submitted to the Senate.

A statement of the history of the activities of the investigating committee and of the preparation and adoption of the report will show that it is based to a large extent upon ex parte proceedings and that it presents only one side of the case.

On June 1, 1925, the Select Committee Investigating the Bureau of Internal Revenue had been in existence for a year and three months. During that time there had been presented to the committee, by its staff, the facts with reference to less than 100 cases, the settlement of which by the Bureau of Internal Revenue was criticised. In respect of these cases which were actually presented to the committee, representatives of the bureau appeared before the committee, full hearings were had, and the bureau answered to the entire satisfaction of at least part of the committee the criticisms made of the settlements.

Under the Senate resolution authorizing its activities the committee was required to cease holding its hearings on June 1, 1925, and was compelled to withdraw its agents from within the Bureau of Internal Revenue on that date and to return to the bureau all of its records which had been withdrawn by the committee and to discontinue the withdrawals from the bureau of records, returns, and cases.

The spirit if not the letter of this resolution was disregarded by committee when it required the bureau to have prepared and s mitted to it prior to June 1 photostatic copies of all returns and pa in thousands of cases. These photostats were then examined by the attorney and agents of the committee without committee hearings and form to a large extent the basis of the majority report.

As illustrative of this, counsel for the committee stated that the portion of the report dealing with amortization was based upon the consideration of all cases involving more than $500,000, some 160 in number, although only some five or six amortization cases had been presented to the committee for its consideration and to the bureau for answer.

The great majority of the cases, therefore, upon which the majority report is based, were never presented to the Bureau of Internal Revenue in order that it might submit a justification or explanation of its action, and, furthermore, were never even presented to the investigating committee. The first time that the committee members themselves heard of these cases was when the report prepared by the committee's counsel was placed before them.

On the 30th of November, 1925, there was submitted to the members of the select committee that portion of a proposed committee report prepared by the committee's staff and dealing with the subject of depletion; on December 10 there was submitted the section dealing with amortization; on December 29 there was submitted the portion dealing with compromises and invested capital; and on January 4, 1926, there was submitted the remainder of the proposed report. On none of these dates was there a meeting of the committee to consider these reports. The receipt of these reports was the first time the committee heard of the thousands of cases examined in an ex parte proceeding, by its staff after the committee hearings ceased.

Representatives of the bureau were allowed to appear before the investigating committee on December 18 to discuss the portion of the report dealing with depletion which had been transmitted to the bureau on December 10, and also were allowed at the committee hearing on December 30 to discuss two other portions of the report, one of which had been submitted to the bureau the previous day and the other of which had been transmitted to the bureau on December 19. The representatives of the bureau were never asked to appear before the committee to discuss the remainder of the proposed report. At these two committee meetings, the representatives of the bureau stated fully their objections to and dissent from the general criticisms contained in the proposed report, but made no attempt to discuss specific cases, stating that such discussion would involve to a large extent repetition of what had been stated at the previous hearings. Furthermore, it was of course clearly impossible for them to have examined in the limited time available the many cases discussed for the first time in the majority report, and the preparation of which by the attorney for the committee had taken many months. (Hearings of special committee, December 18, 1925, pp. 2 and 44.)

On January 11 this report, as prepared by the committee's staff, with three or four minor and more or less clerical corrections, was signed by a majority of the committee and on the following morning presented to the Finance Committee and on the following afternoon to the Senate and released to the press of the country.

This report, prepared by counsel for the committee and containing approximately 250 pages of criticism of the administration of the

Bureau of Internal Revenue and based upon the consideration of thousands of cases that were never presented to the committee and on which the bureau was never heard, went to the press of the country the day following its approval by a majority of the committee and without time for the other members of the committee to present at the same time their views and to point out the errors of fact and conclusions contained in the majority report.

This action has given a gravely erroneous impression to the public.

The report of the majority discusses five general subjects—depletion, amortization, compromises, invested capital and special assessment, and also administrative procedure. Each portion of the report will be taken up and discussed separately. Every case mentioned in the report can not be discussed in detail since a great part of them were never before the committee for its consideration or before the bureau for explanation. Those which were regularly and properly presented to the committee will be discussed briefly for the purpose of showing that the criticisms are unjustified. It is not unfair to assume that the bureau could have answered, equally satisfactorily if it had been given the opportunity, the other cases presented for the first time in the report.

DEPLETION

The criticism contained in the majority report with reference to depletion may be subdivided under four general heads: (1) A criticism of the values determined for depletion purposes in various specific cases; (2) a criticism of the allowance of discovery where the existence of the deposit had been previously known; (3) a criticism of the regulations defining proven area and discovery for purposes of oil depletion; and (4) a criticism of the values determined by the bureau for copper and silver properties.

A brief explanatory statement of the nature of depletion and its effect upon the income tax liability of the taxpayer will be of assistance in understanding the portions of this report and the majority report dealing with the subject. Depletion is a deduction allowed to the operators of mines, oil wells, and other natural deposits, to allow the return tax free of the capital invested in the property. To show the necessity for and the effect of such a deduction a hypothetical case may be stated. Assume that a taxpayer purchased a coal mine containing 100,000 tons of coal for $50,000, and that in a given year he produced 10,000 tons of coal which he sold for $20,000. It is obvious that the $20,000 proceeds from the sale of this coal is not all income to the taxpayer since he has disposed of one-tenth of his coal and has impaired to the extent of one-tenth his original investment in the mine. The deduction for depletion provided for in the law allows the taxpayer to deduct from the gross sales of $20,000 the cost to him of the coal sold, $5,000, the latter figure representing the portion of the cost of the entire mine applicable to the coal sold during the year. Consequently the taxpayer would in the hypothetical case pay a tax on an income of only $15,000, and not on his gross sales of $20,000. The deduction for depletion serves the same purpose to the operator of a mine or other natural deposit as the deduction from gross sales of the cost of the goods sold serves to a retail merchant.

CRITICISM OF MINERAL VALUATIONS IN SPECIFIC CASES

Under the taxing statutes the Bureau of Internal Revenue was forced to value all the mineral properties in this country as of two dates, March 1, 1913, and the date of the incorporation of the taxpayer, both dates many years in the past. The magnitude of this task can be partially appreciated when it is realized that the Interstate Commerce Commission in valuing only the properties of the railroads of the country has spent more than 13 years on the task and more than $27,000,000, and the carriers themselves in working on these same valuations have spent the same period of time and more than $85,000,000. This statement gives some idea as to the magnitude of the bureau's task in valuing all of the mineral properties in the country as of two different dates. Yet the committee after a year and three months of investigation criticizes the values determined by the department in only 15 cases, and 9 out of the 15 were called to the attention of the committee's staff by disgruntled employees or ex-employees of the bureau, whose first determinations of value in the cases had been overruled by their superiors. The attempt in the majority report to condemn the action of the bureau in performing its colossal task by picking out and criticizing 15 exceptional and unique cases is both unfair and absurd. It is merely a vain attempt to use a difference of opinion in a few isolated cases (concerning which there may be an honest difference of opinion by those best informed) as the basis for exaggerated and general criticism.

The valuation by the analytical appraisal method presents a most difficult technical problem, involving in every step the use of individual judgment.

In each case where mineral properties are valued by the analytical appraisal method (which counsel for the committee admits is the only method which can be used in the case of certain properties, such as copper mines) the one making the valuation (first) must estimate the number of tons of ore in the deposit; (second) must estimate the expected price at which minerals will be sold over the life of the property, which may exceed 40 years; (third) must estimate the future cost of producing the minerals over the same period; (fourth) must estimate the period required to recover the estimated units in the deposit; (fifth) must estimate the cost of future plants which will be necessary to recover the minerals; and (sixth) must estimate the interest rate upon the investment which would be necessary to attract capital to invest in the property.

It is perfectly obvious that in estimating any one of the factors stated above the judgment of equally competent and honest engineers will differ. It is with reference to the difficulty of estimating these various factors that Mr. Herbert Hoover in his book Principles of Mining states:

> It should be stated at the outset that it is utterly impossible to accurately value any mine, owing to the many speculative factors involved.

As illustrative of the extent to which individual judgment must enter into these valuations, the Witherbee Sherman case, one of the 15 cases criticized in the majority report, may be cited. In this case the valuation which the engineers of the committee thought should have been placed upon the property differed by approximately

$5,000,000 from the valuation which the bureau had set. At the same time the valuation of the committee's engineers differed by approximately $5,000,000 from the valuation set upon the property by Mr. Grimes, another engineer of the bureau. Yet the majority report, while criticizing the bureau for setting a value $5,000,000 different from what the committee's staff thought proper, nevertheless described Mr. Grimes, who had also set a value on the property differing by the same amount from the committee's valuation, in the following language (p. 103):

> The marked ability and exceptional industry of Mr. Grimes, and the remarkable progress he has made toward reducing appraisal work to a sound, scientific basis is worthy of note and commendation.

Even the majority report admits these differences and shows by a hypothetical case (pp. 114, 115) that two equally competent and equally honest engineers "whose judgment in estimating basic factors differs slightly but not enough to impeach the honesty or ability of either engineer" may reach results that would show a difference in depletion rate of 450 per cent. Yet this almost impossible task of accurately valuing all mineral properties in the United States was placed upon the bureau by Congress. Is it strange that the committee's staff has been able to find a few complicated and involved cases where the judgment of its staff may differ with the judgment of the bureau?

Nevertheless, these same differences in judgment, which, from the very nature of the question can not be avoided, are used in the majority report as the basis for such statements as the following (p. 47):

> Owing to the different views of officers and employees of the unit * * * the grossest kind of discrimination has resulted.

The action of the majority in using this difference in judgment (which, as above shown, is inevitable in the consideration of such questions) as the basis for a general criticism of the bureau and its administration destroys the value of the report, for the purpose of any constructive suggestions or subsequent action, and only serves to materially discount the criticisms contained in the other parts of the report.

DISCOVERY WHERE THE EXISTENCE OF THE DEPOSIT HAD BEEN PREVIOUSLY KNOWN

The report criticizes the settlement of five cases where it is alleged that depletion was allowed on the basis of discovery value although the presence of the mineral was known prior to the date of the alleged discovery, and that the value at discovery was based upon subsequent exploration work. A brief explanation of discovery depletion will assist in understanding the following portions of this report. Under the discovery depletion provisions of the statutes, a taxpayer who discovers a mine or an oil or gas well may base his depletion deduction, not solely upon the cost of the property to him, but upon its value after the discovery is made. The purpose of the provision, which appeared first in the revenue act of 1918, was to encourage the development of the natural resources of the country. Its effect is to allow the taxpayer who makes a discovery the return exempt from tax of the value of the property at the date the discovery is made.

This action of the Bureau of Internal Revenue in refusing to recognize a discovery until the existence of the ore body has been determined by exploration work, and until it is determined to be a deposit commercially valuable, has been directly authorized by the regulations of the Treasury Department since 1920. Article 219 of Regulations 45 was issued April 16, 1919, and signed by Mr. Roper, then Commissioner of Internal Revenue, and by Mr. Carter Glass, then Secretary of the Treasury, and contains the following:

The discovery of a mine or a natural deposit of mineral, whether it be made by an owner of the land or by a lessee, shall be deemed to mean (*a*) the bona fide discovery of a commercially valuable deposit of ore or mineral of a value materially in excess of the cost of discovery in natural exposure or by drilling or other exploration conducted above or below ground, or (*b*) the development and proving of a mineral or ore deposit which has been abandoned or apparently worked out, or sold, leased, or otherwise disposed of, by an owner or lessee prior to the development of a body of ore or mineral of sufficient size, quality, and character to determine it, in connection with the physical and geological conditions of its occurrence, to be a minable deposit of ore or mineral having a value materially in excess of the cost of the proving and development.

This construction of the discovery provision of the taxing law, which is criticized so severely in the majority report, has been in the printed regulations of the Treasury Department since 1919, and has received the approval of the last three Commissioners of Internal Revenue, Messrs. Roper, Williams, and Blair, and the last three Secretaries of the Treasury, Messrs. Glass, Houston, and Mellon. A discussion at the present time of the correctness of this long-standing departmental construction of the law is unnecessary. As stated in the case of Edwards *v.* Wabash Railroad Co. (264 Fed. 610, 618):

The Supreme Court has decided that the reenactment by Congress, without change, of a statute which had previously received long-continued executive construction, is an adoption by Congress of such construction.

TEXAS GULF SULPHUR CO.

The settlement with the Texas Gulf Sulphur Co. is criticized at length in the majority report. An examination of this case demonstrates that the action of the Bureau of Internal Revenue was not only in accordance with the proper legal construction of the statute, but is logically sound.

As to the allowance to the Texas Gulf Sulphur Co. of discovery depletion in 1919, the majority report states that the existence of the deposit was known in 1903 and the extent known in 1909. The real facts in connection with this matter, as shown by the hearings of the committee (p. 4151), are these:

As early as 1903 and 1904 wildcatters, while drilling for oil on the property afterwards acquired by the Texas Gulf Sulphur Co., noticed some sulphur in the slush from the drilling. No attention was paid to it, however, at the time. Mr. Spencer C. Browne, a well-known mining engineer, who in 1910 made a careful examination of the claim that there had been an earlier discovery of sulphur on the property states:

Following the discovery of the Spindletop oil dome near Beaumont, wildcat drilling operations for oil were quickly started on most of the recognizable elevations on the Texas coast. A number of wells were drilled on the Matagorda big hill in 1903 and 1904, and until 1908 a small amount of oil was produced from moderately shallow wells near the higher part of the elevation. While drilling in some of the deeper of these oil wells crystals of sulphur were occasionally brought to the surface, but on account of the peculiar porous character of the sulphur formation the cuttings from the drill were usually lost in the fissures and not seen by the drillers. * * * The drillers were interested only in getting oil and the reports of the occurrence of sulphur carried no evidence of its thickness or extent or quantity (p. 4151).

This is the sole evidence of any discovery of sulphur on this property in 1903.

In 1903 Mr. J. M. Allen, of St. Louis, a promoter and not a mining engineer, in an attempt to financially interest other parties in this property because of the reports of the occurrence of sulphur in the oil wells upon it, got up a report in which he made extravagant claims as to the existence of sulphur on the property. This is the report that is referred to in the majority report as showing the extent of the deposit. The facts are that Mr. Allen was not a mining engineer; that at the time he made these claims he was financially interested in the properties and was attempting to obtain financial support of his plans for development and that there were no reliable or complete data, samples, or logs in existence showing the extent of the sulphur deposit. Some seven years later, in 1910, Mr. Allen, together with his associates, attempted to interest Mr. S. W. Mudd, of Los Angeles, in this property, which they in the meantime had incorporated under the name of the Gulf Sulphur Co. Mr. Mudd sent Mr. Spencer C. Browne, a mining engineer, to examine the property for him and to ascertain whether a sulphur deposit had in fact been discovered. In connection with this examination, Mr. Browne stated:

In 1910, when I first got in touch with this Matagorda Big Hill property, I was not in the employ of the Gulf Sulphur Co. or the St. Louis interests. I was employed by Mr. S. W. Mudd, of Los Angeles, and clients of his who were desirous at the time of investigating sources of sulphur. My opinion of the Matagorda property after my investigation at that time was that it was an interesting prospect that might prove of great value, but that the unsatisfactory character of the development to date had left it wholly unproven. I believed it worthy of further tests by drilling, if the property could be obtained on suitable terms, but would not have been greatly surprised if the drilling campaign (which began in 1917) had disproved the commercial value of the property (p. 4152).

This statement of Mr. Browne is substantiated by the correspondence between him and his client in 1910 which was filed with the bureau when this case was under consideration. For example, in a telegram from Mr. Browne it was stated:

Matagorda long exploited in New York by J. W. Harrison. It was canvassed and considered undesirable by investigators. Pemberton thinks advisable to disregard Matagorda in proceeding with development. I coincide with these views.

In a letter written August 16, 1910, he says:

No records from these oil wells are obtainable * * *. On account of the unreliability of the interested and opposed parties, I can not consider the discussion either favorable or otherwise * * *. As an individual venture I should not recommend development of the Matagorda deposit.

As a result of these discouraging reports on the property (the first that had been made by any competent mining engineer), Mr. Mudd was not interested in it. No further steps toward its exploration seem to have been taken by anyone until some six years later.

In the spring of 1916 the parties who subsequently acquired the ownership of the Gulf Sulphur Co., now the Texas Gulf Sulphur Co., formed an association for the purpose of exploring the property. Beginning in September, 1917, these parties commenced and carried through a comprehensive and scientific drilling campaign to determine whether or not this property contained sulphur in commercial quantities. They employed competent engineers who made an exhaustive examination of the property. This exploration work was carried on from September, 1917, until the spring of 1918. The parties contributed some $625,000 for the purpose of carrying on this exploration work. As a result of this examination, and for the first time, it was determined that large deposits of sulphur, which justified commercial exploration, existed in the property. A discovery was properly allowed by the bureau as of this later date.

It is apparent that the bureau's action in this type of case, which is so severely criticized in the majority report, is not only legally sound, but in view of the facts, is the only action which the bureau could fairly and logically have taken.

OIL DEPLETION

In considering the general subject of discovery depletion, as applied to oil properties, it is necessary and interesting to trace the legislative history of the provision through the various revenue acts.

The revenue act of 1918 for the first time contained a provision allowing, in the case of discoveries of oil, gas, or mines, the depletion deduction to be based upon the fair market value at the date of discovery. The principal importance of the provision of course is in the case of oil and gas wells, since discoveries of mines are very rare. This provision as contained in the revenue act of 1918 placed no limit whatever upon the amount of depletion based upon discovery value. In the revenue act of 1921 Congress, upon the recommendation of the Treasury Department, limited depletion based upon discovery value, to not to exceed the income from the property upon which discovery was claimed. In the revenue act of 1924, again at the recommendation of the Treasury Department, Congress limited the deduction to 50 per cent of the income from the property upon which the discovery was made. Again in connection with the pending revenue bill the Treasury Department recommended before the Ways and Means Committee that discovery depletion be still further limited. It is perfectly obvious, therefore, that the responsibility for allowing depletion based upon discovery value must be placed upon the Congress and not upon the Treasury Department.

The majority report criticizes at length the regulation of the department which permits the allowance of depletion on the basis of discovery value, although the property was proven at the time the well was brought in, provided it was not proven at the time it was acquired by the taxpayer. It also criticizes the regulation which defines a proven area as a square surface of 160 acres.

These regulations were first published on December 2, 1919, in a Treasury decision signed by Mr. Daniel C. Roper, Commissioner of Internal Revenue, and Mr. Carter Glass, Secretary of the Treasury. They have continued in effect until the present day and have also received the approval of Commissioners Williams and Blair and Secretaries Houston and Mellon.

That this Treasury decision was most carefully considered before it was promulgated is shown by the memorandum from Commissioner Roper transmitting the decision to Secretary Glass, in which it is stated:

On the technical points involved, I have had the advice not only of our own technical experts, but those of the Bureau of Mines and the Geological Survey as well. The case was heard before the Advisory Tax Board and has since been thoroughly considered by the bureau, opportunity being given to the taxpayers to be heard.

The criticism by the committee's staff of these regulations, which were so carefully considered prior to their issuance, which have remained in force for such a long time and which have received since their issuance the sanction of Congress in enacting subsequent revenue laws upon two occasions, becomes captious in view of the above history of the regulations.

OIL VALUATIONS

The majority report criticizes the values allowed of oil properties for depletion purposes in a few specific cases. Some of these cases will be discussed for the purpose of showing that the majority report is in error both in its statements of facts and in its conclusions with reference to these specific cases.

BLACK AND SIMONS

In the Black and Simons case it is stated in the committee's report that Black and Simons, each of whom owned an interest in the same oil lease, were given different values for depletion purposes. The report states: "Black, who owned the larger interest, claimed and was allowed a value of $270,059, while Simons, who owned a smaller interest, was allowed a value of $533,887." The real facts with reference to these two valuations are these: Black was tentatively allowed the value which he claimed upon his return. Simons did not accept the valuation tentatively allowed him, but filed an appeal to the Board of Tax Appeals. The bureau very properly made no adjustment of the valuation of Black's property, but is awaiting a decision of the Board of Tax Appeals in the Simons case, at which time both the Black and Simons cases will be disposed of on the same basis; that is, on the basis of the valuation allowed Simons by the Board of Tax Appeals. The committee recognized that this statement of the status of the matter by the bureau officials would ordinarily be a complete and satisfactory explanation of what had been done. The majority report states, however, that:

The Board of Tax Appeals can increase the valuation allowed Simons but can not reduce it. To reduce the valuation would increase the deficiency in tax already determined by the commissioner, and this the board has no jurisdiction to do.

and concludes, therefore, that a proper determination of the cases will not result because of this lack of jurisdiction of the board.

Again the committee's criticism utterly fails because of the inaccuracy of the statements upon which it is based. The board may decrease a valuation and may increase a deficiency. The board stated, for example, in the appeal of Hotel de France Co. (1 B. T. A. 28):

> Where it appears to the board from the record that the deficiency determined by the commissioner is incorrect, the board will, where possible, find the correct deficiency whether greater or less.

See also Rub-No-More (1 B. T. A. 228); Record Abstract Co. (2 B. T. A. 628); Fred Ascher (2 B. T. A. 1257); Peterson Pegau Baking Co. (2 B. T. A. 637); Gutterman-Straus Co. (1 B. T. A. 243).

The criticism of this case by the majority report is as unsound as the statements upon which the criticism is based are incorrect.

GULF OIL CORPORATION

The next oil valuation discussed in the majority report is the case of the Gulf Oil Corporation. Before taking up the specific criticisms contained in the majority report, it is advisable to state the history of the consideration of this case. It should be noted, first, that it was considered and closed by the previous administration prior to the taking of office by Secretary Mellon, and, second, that it received the most careful and painstaking consideration, and that the audit and check of this case was not accomplished in a few days as some seem to think. The facts are that two auditors were originally sent from the bureau at Washington to audit the books of the Gulf Oil Co. during the latter part of October, 1920. Subsequently other auditors were assigned to assist them in their work and the report of this complete examination was not finished until February 20, 1921. The preparation and check of the depletion schedules was handled in the same way, the first being submitted in September of 1920 and the last submitted and checked in February of 1921. It is apparent, therefore, that the consideration and disposition of this case was not unduly hurried but that there was a careful and detailed audit of the case.

The majority report with reference to the Gulf Oil Corporation case criticizes the valuation allowed on the Shumway lease of the Gypsy Oil Co., a subsidiary of the Gulf Oil Corporation; it states that the valuation of this lease was typical of the valuation of all other leases in the case, and concludes, consequently, that the settlement of the case resulted in the payment by the company of substantially less tax than should have been paid. The alleged error in the valuation of the Shumway lease is the sole foundation for the statements in the majority report which occasioned the following headlines in the New York Times and similar headlines in other newspapers: "Couzens committee's report reveals Mellon's Gulf Co. benefited by $4,590,385."

If the conclusion in the report of the majority of the committee that the Shumway lease was overvalued fails, then the other conclusions, including the one that the Gulf Co. underpaid its taxes, necessarily fails.

The value allowed the Shumway lease is criticized in the majority report in three respects. First, it is stated that in valuing the lease the bureau used the price of oil on the 31st day, while the law requires the use of the price of oil within 30 days after discovery; second, it is stated that no proper allowance for hazard or discount was made in the valuation of this lease, and, third, it is stated that although the records show that many dry holes were drilled in this county, nevertheless in valuing this lease no allowance was made for dry holes.

A brief statement of the history of the Shumway lease and its development by the Gypsy Oil Co., as shown on pages 2883–2899 of the records of the investigating committee is necessary to answer the committee's criticisms.

The Gypsy Oil Co. acquired the Shumway lease on January 24, 1916. At that time it was miles from any oil production, so that in no sense could it be called proven or even probable oil land. Early in 1917, as a result of careful surveys, the surface geology of the region was mapped, and the indications were that the Shumway lease was favorably situated provided there was any oil in the surrounding territory. At that time shallow oil (550 to 600) was being produced in the Eldorado pool, about 5 miles east and north of the Shumway lease, and a deeper oil from the Augusta pool, 6 miles or more to the south. In March, 1917, the Alpine Oil Co. drilled a well into the deep sand (2,400 feet) which opened an entirely new pool. This well was a small one and attracted little attention until it was followed on May 30 by the Trapshooter well, which definitely established the existence of a new pool of great magnitude. The Gypsy immediately took steps to drill up the Shumway lease, which even then gave promise of being one of the best in this district. On July 15, 1917, the drill reached the sand and on July 16 the first oil was produced, although the well was not finished and put into regular production until several days later. Production after completion was estimated at 5,000 barrels a day. From that time until the full quota of wells was drilled, development proceeded rapidly, which was necessary since the Gypsy Co. owned this single quarter section surrounded by leases of its competitors.

The field was peculiar in the Mid-Continent field in that there was no gas. The oil was forced to the surface by hydraulic pressure. Since Shumway had a structural advantage of 20 to 30 feet over leases to the south and west, this made it apparent that careful drilling would result in the production of a vast quantity of oil from the lease.

The report first criticizes the valuation of this lease because of the use of the price of oil on August 15, stating that the oil was discovered on July 14, and therefore that the 30-day period for valuation expired on August 14. The real facts, contrary to the statement appearing in the majority report, are that the first oil from the lease was not produced until July 16 (record, p. 2895), so the use of the price of oil on August 15 was within 30 days after the discovery and was entirely proper.

The next criticism is of the failure to make proper allowance for discount and hazard in valuing this lease. It should be realized that in valuing a discovery well the greatest hazard in the oil industry has already been eliminated. The presence of oil in commercial quantities must be assured before a discovery valuation is permissible. When the presence of oil in commercial quantities has been demonstrated by a discovery, the remaining factors concerning which uncertainty exists are these: First, the amount of the future production of the well; second, the future selling price of the oil, and, third, the cost of producing the oil If in determining these factors the estimates are conservative and the hazard element is taken care of, then the discount factor must compensate only for the use of the money. In other words, when hazard is taken care of in the estimates of the three items specified above, a 4½ or 5 per cent discount rate to compensate for the use of the money while it is tied up in the well is adequate. In the valuation of this lease the estimate of the reserves was reduced by the bureau in order to take care of the hazard factor from 9,199,330 barrels, the estimate used by the company for its own purposes, to 6,836,000, a reduction of 25.7 per cent. In addition a straight discount factor of 5 per cent was used to compensate the supposititious investor for the use of his money. Thus in valuing this property an allowance of 25.7 per cent was made for hazard and 5 per cent for discount. The combined allowance was certainly adequate to take care of both factors. Again the facts do not support the statements made in the majority report.

The report, after reviewing the history of all of Butler County, the county in which the Shumway lease was located, and showing that 15 per cent of the wells drilled in the county were dry holes, criticizes the valuation placed on the Shumway lease for a failure to make allowances for dry holes. A consideration of all of Butler County is entirely valueless since there are included therein three separate and distinct pools and it was well known at the time the Shumway was brought in that it was in a new pool. The judgment of the engineers valuing this lease in failing to make any allowance for dry holes is fully supported by subsequent facts which show that not a single dry hole was brought in on this lease (p. 2896).

The above answers conclusively every specific criticism made of the valuation of the Shumway lease. In addition, the actual performance of the Shumway lease may be stated to show further that the value placed was conservative.

In preparing the valuation of the Shumway lease the oil reserves were estimated at 6,800,000 barrels. Up to January 1, 1925, the lease had actually produced more than 7,250,000 barrels. The appreciated value placed on the lease because of discovery was $9,800,000 and the net profits from the well up to December 31, 1924, were $12,306,000, and at that time the well was still producing at the rate of 248 barrels a day. It surely can not be claimed that the value placed on this lease was excessive when subsequent events show that up to January 1, 1925, the well had paid out approximately 25 per cent in excess of the value placed upon it by the bureau and was still producing in a substantial amount.

The entire criticism of the settlement of the Gulf case, based entirely upon criticisms of the valuation of the Shumway lease, must fall. However, the unfortunate and wholly unwarranted impression that may have been made in the minds of the public through the majority report, with its erroneous statements of facts and conclusions concerning this case, can not be removed by this complete explanation and justification of its settlement.

Had this majority report been withheld until the minority had opportunity to prepare its report, the public could have at least heard both sides of the case.

CONNOLLEY AND LARKIN CASE

The third oil valuation criticized in the majority report is the case of Connolley and Larkin. The majority report alleges that a given well was valued as of a given date at four different figures for the purpose of determining the depletion deductions of the five parties owning undivided fractional interests in the well. The report in stating that these allowances were actually made to the five parties is directly contrary to the facts, which are clearly set forth on pages 2974 and 2975 of the committee's hearing. In July of 1924, approximately a year before this case was ever considered by the investigating committee, the discrepancies in the tentative valuations of these undivided interests were detected not by this committee, as the majority report would have you believe, but by the bureau, and a uniform valuation was given to the property for the purpose of determining the depletion of all the parties, and the taxes of the various parties, so far as possible under the statute of limitations, were adjusted accordingly. Again, the statement in the majority report is contrary to the facts, as shown by the committee's own record.

COPPER AND SILVER VALUATIONS

The sole remaining criticism contained in the majority report with reference to the administration by the bureau of the depletion sections of the law deals with the valuation for depletion purposes of copper and silver properties. A mere statement of the history of these valuations will disclose the absence of any grounds for just criticism.

In 1919 the returns filed by the copper companies had not been audited and the valuation of the copper mines of the country had not been made. It was necessary under the law to value these properties as of two dates, first, as of March 1, 1913, for depletion purposes, and, second, at the date paid into the corporation for invested capital purposes. To do this work the bureau called in Mr. L. C. Graton, a mining engineer thoroughly familiar with copper valuations and specially qualified to perform this work. Mr. Graton, whose services for the bureau were secured by Commissioner Roper, had been formerly a professor at Harvard and in addition had been for nine years in geological survey work giving particular attention to copper matters. Neither his integrity nor his splendid ability have been or could be questioned by the committee. Mr. Graton valued the properties of the copper producers of the country in the latter part of 1919 and the early part of 1920.

Although these valuations were marked provisional, subsequently in 1920 conferences were held with representatives of the copper companies, at which additional data were furnished and the valuations tentatively made by Mr. Graton were made final. These valuations were approved by Commissioner Roper in 1920. Taxes for 1917 and 1918 were assessed and paid by the companies on the basis of these valuations and the companies were informed that the years were closed. In 1922 engineers of the bureau called to the attention of the commissioner, the valuations which had been made of the copper properties, contending that they were excessive. After thorough consideration of the problem, it was decided by the commissioner that the original values were excessive, although the differences between the engineers who made the original valuations and those who proposed the revaluations were almost entirely differences in judgment on very close points.

The history of the valuation of the silver properties is substantially the same as that of copper properties except that upon consideration of the proposal to revalue it was determined that the basic principles of the original valuations were sound and it was ordered that those original valuations should be revised only if necessary to correct actual errors.

The original valuation for 1917 and 1918 was made by competent authorities and was an honest expression of judgment. The taxpayers had considered their taxes for 1917 and 1918 closed and arranged their finances accordingly. To reopen them at this late date would have upset an entire industry. The bureau, therefore, took the position that the 1917 and 1918 taxes having been finally settled and paid, it would not extend the revaluation to those years, but would commence with the year 1919, for which year and subsequent years taxes had not yet been determined. It was felt that the bureau should not substitute its present judgment for the honest judgment of those officials of the prior administration who were formerly in authority in the bureau and who had finally closed the cases for 1917 and 1918. Such action was both wise and proper and affords the basis for no just criticism.

AMORTIZATION

In discussing the general subject of amortization it is helpful to state, first, the purpose and effect of the provision and, second, to state the legislative history of the provision and to show the tremendous and novel task which it imposed upon the Bureau of Internal Revenue.

The amortization section, which affects only the war years and which is contained only in the revenue acts of 1918 and 1921, allows those taxpayers who acquired plants or machinery or other facilities during the war period and for the production of articles contributing to the prosecution of the war to take as a deduction against their income for the war years, the cost of those facilities which would be useless to them after the war or that portion of the cost of the facilities which was attributable to the high war costs. In other words, the provision was for the purpose of allowing a deduction of the excessively high war costs of facilities, buildings, and machinery against the high war income produced by those facilities.

The section providing for an allowance for the amortization of war facilities appears first in the revenue act of 1918. This section in the revenue bill as passed by the House contained the proviso that the amortization deduction should in no case exceed 25 per cent of the net income of the taxpayer. The Ways and Means Committee of the House was at first very insistent upon this limitation on the ground that without such a limitation too much discretion would be given to the officials of the Bureau of Internal Revenue. This limitation, however, was stricken out of the bill by the Senate and does not appear in the 1918 statute as it was finally enacted into law. In other words, the advisability of imposing some limitation upon the broad discretion given to the bureau officials by the amortization section of the act, was considered by Congress, and after thorough consideration it was rejected. That Congress realized the tremendous discretion which this section placed in the Treasury officials, is shown by the discussion of the section at the time it was under consideration. Mr. Claude Kitchin in discussing this section stated:

> Some gentlemen have asked me about the amortization proposition. You will find the amortization provision on page 37. It applies to individuals and to corporations for the purpose of computing net income for both the income tax and the excess-profits or war-profits tax. This provision gives great power of discretion to the Treasury Department, to the Commissioner of Internal Revenue, and the proposed advisory tax board. We must lodge that discretion somewhere. * * * It must be lodged somewhere, because Congress can not take up each one of the particular cases and fix a certain rule by which a building may be amortized. We can not do it. * * * (Appendix to the Congressional Record, vol. 56, pt. 12.)

In discussing this and other provisions on the floor of the Senate, Senator Smoot stated:

> I want Senators to know that in these provisions there is placed in the hands of the Commissioner of Internal Revenue or the Secretary of the Treasury, as the case may be, a power that has never been granted to departmental officials before.

Congress therefore advisedly and after thorough consideration enacted the amortization section of the war revenue acts, realizing the tremendous discretion it placed in the Treasury officials, but appreciating, as the majority report of this committee apparently does not, that the discretion had to be lodged somewhere, since it could not be exercised in individual cases by the Congress.

The section in question provides for the deduction, "in the case of * * * facilities * * * constructed * * * for the production of articles contributing to the prosecution of the war," of "a reasonable allowance for the amortization" of such facilities. Under this vague and indefinite language, which placed practically unlimited discretion in the hands of the officials of the department, the bureau was required to make more than $600,000,000 of allowances. This investigating committee, after a year and three months of investigation, in which every amortization case involving any substantial amount was carefully examined, has found no evidence whatever of any irregularity, any corruption or any fraud in these allowances. This record is a remarkable tribute to the bureau. It can not be marred by the attempt in the majority report to exaggerate honest and unavoidable differences of opinion which have arisen in connection with the determination of this allowance in individual cases.

One of the first questions which arose in administering the amortization section of the statute was whether it should apply to a case where a taxpayer acquired facilities for his war production which gave him a production capacity in excess of his postwar needs. The majority report criticizes the bureau for allowing amortization in such cases, the position being taken that any allowance for amortization in such cases was illegal. This criticism of the action of the bureau is fully answered by the history of the administration of the amortization section. After careful consideration it was definitely determined that amortization should be allowed in such cases and a regulation was issued April 16, 1919, and signed by Mr. Daniel C. Roper, Commissioner of Internal Revenue, and Mr. Carter Glass, Secretary of the Treasury.

This regulation has been continued in effect until the present time and has received the approval of all the Commissioners of Internal Revenue and of all the Secretaries of the Treasury from April 16, 1919, until to-day. It is unnecessary now to enter into a legal argument to justify a regulation with such a history.

The remainder of the majority report dealing with amortization, some 60 pages of the report, deals with various criticisms of the method used by the department in determining the postwar value in use of facilities acquired by taxpayers during the war for war purposes. The possibility of differences in this connection and the inherent difficulty of the subject is shown by the United States Steel case (only one of thousands) which necessitated the determination of the postwar value in use of all assets acquired by the company for war purposes, which represented expenditures of approximately $250,000,000. The magnitude of this work, its difficulties and the opportunities for honest differences of opinion in this one case, must be obvious to all. Any argument, however, at the present time, over the proper method of computing this postwar value in use is unnecessary. In October of 1925 there was published by the Bureau of Internal Revenue a ruling (S. M. 4225) setting forth complete and detailed rules of procedure for determining the postwar value in use of facilities. This opinion, which the bureau states will be used in determining amortization in all cases not barred by the statute of limitations, is in substantial accord with the staff of the investigating committee. Members of the investigating committee who signed the majority report have indicated that if this opinion had been in effect for the determination of all amortization allowances, there would be no grounds for criticism. (Hearing before Finance Committee, pp. 31, 108, 153.) Therefore as to the basis to be used in settling all unclosed cases, the Bureau of Internal Revenue, the members of the investigating committee, and the committee's staff are in complete accord.

The sole point remaining is with reference to certain minor inconsistencies in cases closed before the complete procedure now in effect in the bureau was worked out. The attitude of the majority of the committee appears to be that perfection in construing a novel statute must be achieved immediately after its enactment, and that the administration by the bureau from the beginning should have been what it finally became after its six or seven years of experience in determining amortization. The determination of "a reasonable allowance for the amortization" of war facilities involving allowances of more than $600,000,000 presented a problem on which there were no rules or precedents. It was pioneer work. To expect that under such a statute authorizing "reasonable allowance" a hard and fast policy could be established at the very outset of its administration and adhered to throughout, a policy which would work justice to all parties, is to expect a degree of foresight on the part of the bureau officials which is beyond reason. In working with individual cases, observing the practical working out of the different theories and methods, encountering varying conditions and facts, the bureau officials gained knowledge which enabled them to apply the provisions of the statute more accurately and more fairly. The rules laid down in the opinion of O tober, 1925, represent the knowledge gained by some seven years of experience in administering the statute. Obviously the methods prescribed therein are an improvement over those which were used in 1920 in the determination of amortization in the first cases taken up for consideration. To state otherwise would imply that the bureau had learned nothing through seven years of dealing with actual cases and applying the statute to varying conditions. This progress and improvement in administration by the bureau should be praised and not criticized.

The subject of amortization is now a dead one. No such provision is contained in the current revenue laws and the last year affected by the deduction is the year 1920. The procedure for determining amortization now in effect in the bureau and which will be applied to all unclosed cases is admittedly sound. Inconsistencies between the present method of determining amortization and the method in effect several years ago and shortly after the act was passed. merely show that the bureau has made progress in this work and by experience has improved. The bureau deserves great praise for having exercised, intelligently and honestly, the tremendous discretion given it by Congress in determining more than $600,000,000 of amortization allowances under an imperfect, vague, and indefinite statute.

COMPROMISES

The next section of the majority report deals with the compromise of taxes where the taxpayer is insolvent. The action of the bureau in compromising taxes for an amount less than could be collected by the enforcement of the Government's legal rights is criticized in the report as being illegal and the case of the Atlantic, Gulf & West Indies Steamship Co. is discussed as showing the effect of this illegal policy as applied to a specific case. In condemning this compromise policy as illegal the report states (p. 190):

> Deliberately compromising taxes for less than can be collected is an abuse of discretion and constitutes a voluntary relinquishment without consideration of a debt due the Government. This, the Attorney General has said, the commissioner is not authorized to do. In making such compromise the commissioner has arrogated to himself the function of determining, not what can be collected, but the tax rate at which the taxpayer should be taxed. It is doubtful whether Congress could delegate such authority, and it is clear that it has not attempted to do so.

This language is particularly interesting when compared with the opinion of Attorney General MacVeagh, rendered in 1881 and reported in 17 Op. Attys. Gen. 213, wherein it is concluded:

> I have, therefore, to advise you that while, in considering any compromise submitted to your judgment, you are not at liberty to act from motives merely of compassion or charity; you are at liberty, until Congress sees fit to limit your authority, to consider not only the pecuniary interests of the Treasury, but also general considerations of justice and equity and of public policy.

The majority report, citing some dictum in an opinion of the Attorney General published in 16 Op. Attys. Gen. 249, condemns as illegal a practice which was directly and specifically authorized in a subsequent opinion of the Attorney General rendered in 1881 and continued in force until the present time. Such a criticism deserves no further consideration.

INVESTED CAPITAL AND SPECIAL ASSESSMENT

The portion of the majority report dealing with invested capital and special assessment criticizes severely the regulations issued under the invested capital and special assessment provisions of the revenue act of 1917. Without discussing the purpose of the committee in considering at this time regulations peculiar to the revenue act of 1917, it is only necessary in explanation of these regulations to cite the history of their consideration and adoption.

After the enactment of the revenue act of 1917 considerable doubt existed as to whether its provisions could be enforced and applied, in view of the haste with which it was written and the inexperience of its authors with an excess profits tax. The regulations issued under this act were therefore the subject of most careful consideration prior to their issuance. The history of the preparation and issuance of these regulations is contained in the report of Commissioner Roper to Secretary of the Treasury, Mr. McAdoo, for the year 1918, which states in part:

> Despite grave apprehension that the law could not be interpreted in a way that would admit of orderly and effective administration and the expressed views of many citizens that immediate amendments of the law should be sought from Congress before attempting to administer it, the department proceeded with the analysis of the law in the confidence that the congressional intent and purpose could be interpreted and put into effect without further legislative action and without serious detriment to industry and business.
>
> The vital effect the enforcement of the law would have upon the economic activities of the country made it highly desirable to analyze and interpret the law in the light of all available information regarding business and industrial conditions and practices. The Secretary of the Treasury, therefore, selected to assist the commissioner of internal revenue a group of prominent business and professional men, whose training and experience seemed especially to qualify them for the task. This group was designated as "Excess-profits tax advisers." It included men possessing extensive knowledge and experience in agriculture, manufacturing, trading, finance, accountancy, legislation, political economy, and sociology. These advisers were not only specialists in one or more of these fields, but were keenly appreciative of the administrative responsibilities resting upon the bureau and possessed much knowledge of business and industrial conditions in their respective sections of the country. They brought to the department a composite experience and breadth of view that proved of inestimable value in the study of the intricate law which the bureau was called upon to administer. The Solicitor of Internal Revenue and members of the bureau's legal staff and the administrative officers of the bureau were closely coordinated with the excess-profits tax advisers in their work.
>
> The appointment of the excess-profits tax advisors had the immediate effect of inspiring confidence in the purpose of the department to administer the law with due regard for established business practices and with proper consideration of the effect the large rates of tax would have upon business activities. The tide of general criticism that had arisen against the law was stemmed, and the bureau began to receive innumerable expressions of confidence and offers of cooperation and assistance from accountants, lawyers, bankers, and business men throughout the country.
>
> Information, advice, and suggestions were sought from taxpayers through all known channels. Hearings were conducted for the oral discussion of the law and the concrete cases to which it would have to be applied. After months of thorough and painstaking deliberation, regulations were issued interpreting the principal features of the excess-profits tax provisions and establishing the administrative procedure with reference to them. These regulations and the subsequent Treasury decisions and bureau rulings have been accepted generally as fair interpretations of the purpose and intent of the law.

These regulations which are declared in the majority report to be illegal, and which are cited as involving the loss of millions of dollars in taxes to the Government, were issued in 1918 by a Treasury decision signed by Commissioner Roper and approved by Secretary McAdoo. They have been continued in force until the present day for the purpose of determining the taxes under the 1917 act and have received the approval of the last three Commissioners of Internal Revenue and the last four Secretaries of the Treasury.

Not only did these regulations before this adoption receive their marked and careful consideration above pointed out, but were immediately called to the attention of the Congress and were embodied in the revenue act of 1918. The report of the Senate Committee on Finance, of which Senator Simmons was chairman, on the revenue act of 1918, at page 13, in speaking of an amendment the purpose of which was to write into the 1918 act the provisions of the regulations under the 1917 act on paid-in surplus, which are so harshly criticized in the majority report, states:

> 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 statutory basis and continued.

The regulation under the special assessment section of the 1917 act was likewise approved by the Congress and embodied in the 1918 act. (See S. Rept. 617, p. 14.)

These regulations, therefore, represent not only the long-continued construction of the executive department, but in addition were specifically approved by Congress in 1918 within one year after their adoption. Their resurrection at the present time to form the basis for an attack upon the administration of the bureau illustrates the limits to which the majority of the committee has gone in this so-called constructive investigation.

ADMINISTRATIVE PROCEDURE

Although the investigating committee never accepted the invitation of bureau officials to inspect the various units and divisions of the bureau in order to see the procedure in effect in the handling of cases and has never made any attempt to observe first-hand the actual workings of the bureau, nevertheless the last portion of the majority report is devoted to criticism of the organization and procedure of the bureau.

The organization is criticized on the ground that the head of a division of the bureau is supreme and may, irrespective of the law and regulations, dispose of a case as he may see fit. It is obvious, since all the activities of the bureau can not be performed under the direct personal supervision of the Commissioner of Internal Revenue, that he must delegate to subordinates, selected for their ability and qualifications, certain duties and responsibilities. In delegating authority as to the disposition of cases, however, every attempt has been made in the bureau organization to secure thorough and adequate review of proposed settlements. The first step in connection with the audit of a given case is the revenue agent's examination which forms the basis for a complete report by him. The case is then handled by the auditor in the bureau to whom it is assigned, in conjunction with his subsection chief and a conferee, the latter being a specially trained technical man. After the audit of the case and the revenue agent's report by this auditor with the assistance described above, the case is sent to the review section of the division. The personnel of this review section is selected from the most experienced, able, and trustworthy men of the bureau. It is there carefully reviewed, and any error which is discovered is corrected. The case is then sent to the head of the division for his approval.

If in connection with the case a question of law is raised, or if in its consideration a difference of opinion arises between the review section and the audit section or between the head of a division and the review or audit section, the case is referred to the representative of the Solicitor of Internal Revenue assigned to that division. The point in dispute is then either settled by him or referred by him to the office of the Solicitor of Internal Revenue for an opinion. If the case involves a refund of $50,000 or more after the approval by the head of the division, it is automatically sent to the office of the Solicitor of Internal Revenue for a thorough and detailed review. This brief statement of the procedure in effect in the auditing of tax cases discloses that even where authority is delegated by the commissioner, every effort is made through reviews and checks to see that it is not abused. It discloses further that so far as it is possible to do so by a system of procedure, every step has been taken to protect the interests of the Government.

FAILURE TO PUBLISH RULES AND REGULATIONS

The report criticizes the administration of the bureau because all of the various rulings under the law and regulations have not been published. Up until the latter part of 1919 none of the rulings of the bureau was issued to the public. It is interesting to note that Great Britain, with the experience of more than half a century in administering an income tax law, has never published either general regulations or specific rulings. In 1920 the policy was inaugurated of publishing a weekly bulletin containing all rulings involving a question of principle or having any general application. The policy has been continued and enlarged up to the present time, during which time there have been published approximately 2,000 pages of regulations on the income tax and in addition more than 4,500 rulings, comprising about 5,300 printed pages.

Not only have these rulings of general application been published, but the bulletins in which rulings are published have contained for the last two years a statement on their covers as follows:

> No unpublished ruling or decision will be cited or relied upon by any officer or employee of the Bureau of Internal Revenue as a precedent in the disposition of other cases.

Surely everything possible has been done by the bureau to insure the publication of rulings and to prohibit the settlement of cases in accordance with any ruling not published.

ACCOMPLISHMENTS OF THE BUREAU

In the foregoing part of this report the criticisms of the Bureau of Internal Revenue contained in the majority report have been considered, weighed, and we submit conclusively answered. Now it is proposed to review the accomplishments of the Bureau of Internal

Revenue, something which the majority report neglects to do, and to consider the size of the task given by Congress to the bureau and its success in performing it. This will disclose whether or not the statements in the majority report, even though they were assumed to be correct, could properly form the basis for any general criticism of the administration by the bureau in collecting war taxes.

Prior to the year 1913 the greater part of the revenue of the Government was derived from the tax on distilled spirits, liquors, and tobacco, and the tax collected for that year amounted to only $350,000,000. The first income tax law, which was passed in 1913, was simple in its provisions and very moderate in its rates. The taxes collected for the first few years after its enactment averaged only $430,000,000 a year. It was when this country entered the World War that the demand for revenues multiplied, the existing tax rates were increased, and new taxes novel and untried were imposed. It was then that Congress began to place a stupendous burden upon the Bureau of Internal Revenue.

The revenue collected by the bureau increased from $512,000,000 in 1916 to $800,000,000 in 1917, an increase of 58 per cent; to $3,690,000,000 in 1918, an increase of 621 per cent; to $3,850,000,000 in 1919, an increase of 658 per cent; to $5,400,000,000 in 1920, or a 956 per cent increase over the collections for 1916. There were 770,000 income-tax returns filed in 1916. This number increased yearly to 8,700,000 in 1921, an increase of 1,020 per cent. This tremendous increase in the revenue and in the number of returns filed, and the increase in the work to be performed as a consequence thereof, imposed an unheard of burden upon the Bureau of Internal Revenue. The bureau was not prepared to handle the work or to start the audit of the returns as they came in. The first of 1918 the entire organization in Washington contained less than 600 officers and employees. Experienced lawyers, engineers, and auditors had to be secured and trained to build up the Washington organization to its present personnel of over 6,000 in order to audit the returns and finally settle the cases.

Some of the duties imposed upon the bureau in connection with the auditing of income and excess-profits tax returns may be stated in order to show the magnitude of the task. The law required the valuation of all the natural resources—mines, metals, timber, and oil and gas—in this country as of March 1, 1913, and as of the date paid into the corporation for stock. All other tangible property owned by taxpayers also had to be valued as of the same two dates for depreciation and invested capital purposes. Amortization allowances involving the consideration of an absolutely novel allowance, had to be determined in an amount in excess of $600,000,000. In determining invested capital and depreciation a value had to be placed upon all the intangible properties, including patents, copyrights, good will, processes and secret formulas, no precedents for the valuation of which existed. The income of the millions of taxpayers who made returns had to be determined after a careful audit of their accounts, and in the case of corporations the annual income for every year since the incorporation of the company had to be determined for the purpose of computing invested capital. There is no case in history where a similar or comparable burden has been placed upon an executive department.

The Bureau of Internal Revenue, overcoming the greatest difficulties, has succeeded in becoming practically current in its work of auditing these returns and adjusting the taxes. In December, 1925, there remained unclosed only 0.07 of 1 per cent of the 1917 cases; 0.09 of 1 per cent of the 1918 cases; 0.13 of 1 per cent of the 1919 cases; 0.38 of 1 per cent of the 1920 cases; 0.63 of 1 per cent of the 1921 cases; 3.54 per cent of the 1922 cases; 3.94 per cent of the 1923 cases; and 5.94 per cent of the 1924 cases. And this progress has been made in spite of the fact that in the last seven years more than 600,000 cases have been reopened by taxpayers through the filing of claims for refund, which claims for refund must, under the law, be examined, considered, and passed upon by the bureau. The proportions which a single case may assume is brought out by the case of the United States Steel Corporation, in which case the assessment letter merely showed the mathematical adjustments, covering 2,267 pages with 317 pages of exhibits. And the difficulty of the questions presented in adjusting the case is shown by the fact that of the last 15 income-tax cases decided by the Supreme Court, 9 of the cases have been decided by a divided court. The accomplishments of the bureau are as remarkable as its task was colossal.

As a result of the work of the Bureau of Internal Revenue in auditing these returns, there has been collected in additional taxes for the fiscal years 1917 to 1925 more than $2,800,000,000, and the collections as a result of audit for the first quarter of the fiscal year 1926 amounted to more than $75,000,000. The work of the bureau in auditing these returns needs no justification other than the figures showing the result of these audits.

The accomplishments of the bureau are clearly and strikingly presented in the following summary: Since the passage of the income tax act of 1917 there have been filed more than 59,000,000 income-tax returns. During the same period the Bureau of Internal Revenue has collected and accounted for more than $30,000,000,000. Of this amount more than $2,800,000,000 has been collected as a result of the audit and investigation of tax returns. The cost of collecting this tremendous sum of money has averaged less than $1 for each $100 collected. Less than 1,000,000 cases remain at the present time to be settled and finally adjusted out of the 59,000,000 cases filed during and since the war.

In the investigation, the accomplishments of the bureau as a whole were not examined for the purpose of determining whether, considering the size of the task, it had been well performed. On the contrary, individual cases which had been settled by the bureau were reexamined for the seeming purpose of finding something to criticize in connection with the settlement.

The entire record discloses the desire to examine and present cases which might form the basis for criticism of the bureau. The record of the hearings, as well as the report itself, shows that it was the unusual and unique cases, called to the attention of the committee with the suggestion of irregularity in the settlement, which were investigated. It is impossible for such an investigation to show a complete cross section of the work of the bureau; it necessarily and purposely shows only the rough spots. But the bureau has ended up with a clean record even after that type of an investigation.

The accomplishments of the bureau in collecting more than $30,000,000,000 in revenue and in auditing and closing 58,000,000 cases has been subjected for the last year and three months to this type of critical investigating by the investigating committee and its staff, composed of some 50 lawyers, engineers, accountants, and clerks. It has resulted in a criticism of various regulations which had received the approval of two administrations and many competent and able authorities on taxation, besides disclosing a difference of judgment in some specific cases. The investigation has disclosed no hint of any irregularity or fraud. That the bureau can so successfully withstand such a searching and critical investigation is a great tribute both to its present and past officials and employees. The bureau is entitled to the respect, admiration, and praise of the Congress and of the country for the honest and efficient way in which it has performed its work.

JAMES E. WATSON,
RICHARD P. ERNST,
Members of the Select Committee Investigating the Bureau of Internal Revenue.

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Nos. 3 and 4, driven by C and D Cos., the A Co. is allowed a full discovery exemption on each of these 80-acre tracts, because the company had the lease before wells Nos. 3 and 4 were brought in.

The E Oil Co. now acquires the 80 acres lying east of A Co.'s quarter section S–16. (The shaded area on the diagram.) They bring in well No. 7 and get the discovery exemption, because it is outside of any 160 acres proven area. This well No. 7 proves practically 80 acres of A Co.'s quarter section S–16, but nevertheless this latter company on drilling their well No. 8 close by, gets the discovery exemption because the lease was acquired before the E Co. brought in well No. 7.

A Co. now drills well No. 9 between quarter sections S–7 and S–8, and well No. 10 between quarter sections S–11 and S–12, to prevent losing discovery depletion under the regulation which provides that a discovery will not be allowed when the area is entirely surrounded by proven areas. Through wells No. 9 and 10, therefore, the A Co. proves and gets the discovery exemption on all the oil under the 320-acre tract in which these wells are located.

This carries the illustration far enough to show how the entire area east of the original discovery well No. 1 can be blanketed with discovery exemptions. By the same process the areas north, south, and west of the original well can be blanketed until the limits of the pool are reached.

On the diagram we have carried the process out by putting in wells Nos. 11 to 43, inclusive, and showing additional leases F to R, inclusive. The diagram is self-explanatory.

By judicious drilling, then, the A Co. can get the discovery exemption on their whole 2,560 acres with the exception of the 10 acres subleased; and they can do this without making a single real discovery and without taking any real risk in drilling. Out of the 2,560 acres under lease by the A Co. the discovery exemption is actually allowed on 1,270 acres which have been proven by others even on the arbitrary 160-acre rule of the bureau.

The map on the opposite page shows how H. V. Foster actually blanketed a 640-acre tract with 10 "discovery" wells (2901–2902).

Foster acquired a lease on section 25, range 25–9, Osage County, Okla., on December 16, 1910, for which he paid no bonus. Through these 10 discoveries on this 640-acre tract he has secured discovery exemption amounting to $2,231,329.

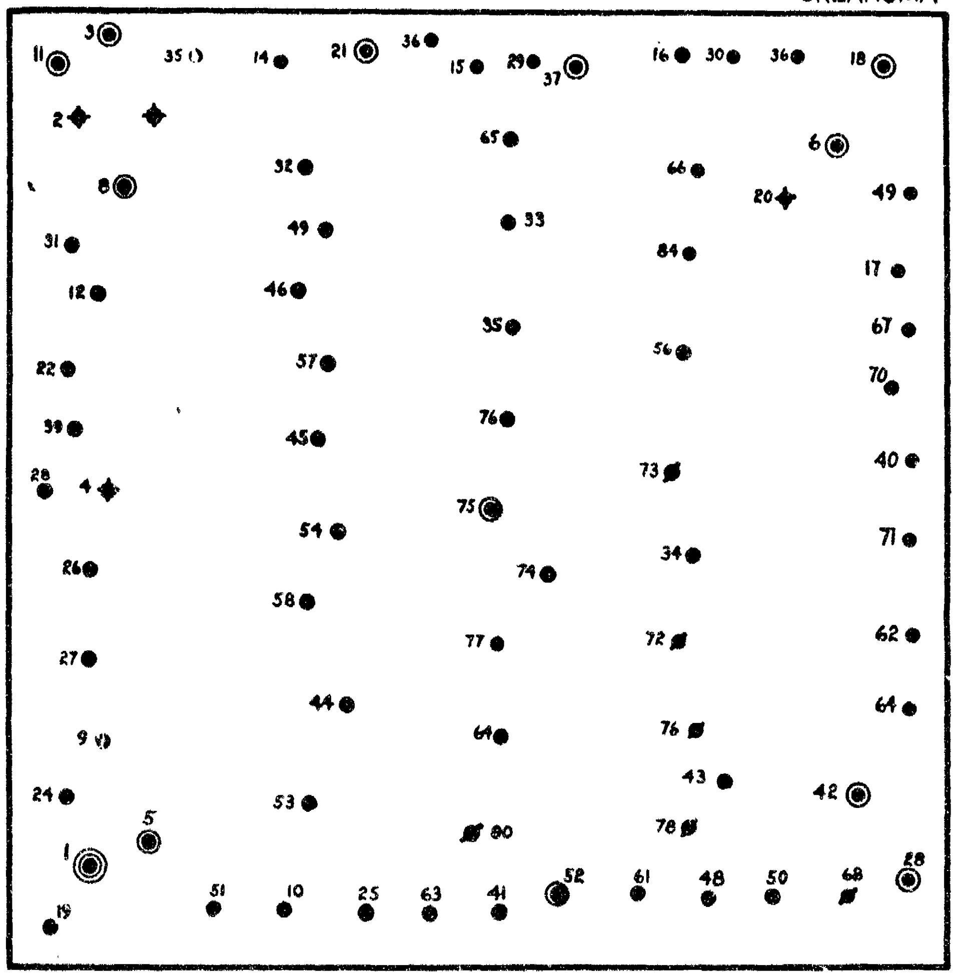
The order in which the wells were brought in, the acreage within Foster's lease proven by each well, the discovery exemption allowed, and the general location of the discovery areas are as follows:

Order	Well No.	Acreage proven	Discovery exemption	General location on section
First	1	49.5	$3,554.10	Southwest corner.
Second	5	56.0	148,449.28	Directly east of well No. 1.
Third	9	123.25	161,146.72	Center of section.
Fourth	15	60.0	201,755.93	Northwest corner.
Fifth	16	49.0	467,447.50	Southeast corner.
Sixth	19	7.5	112,451.38	South side between wells 5 and 6.
Seventh	23	96.25	339,729.12	Center of east side.
Eighth	26	67.0	502,990.29	Center of north side and small square and between 15 and 9.
Ninth	27	34.3	236,238.00	Northeast corner.
Tenth	35	18.0	57,567.50	North side between wells 26 and 27.

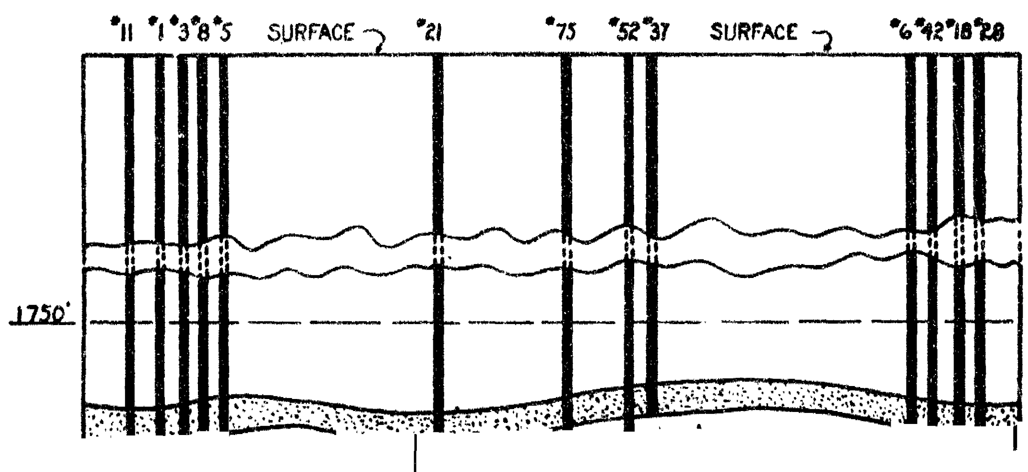
DISCOVERIES CLAIMED GYPSY OIL CO.

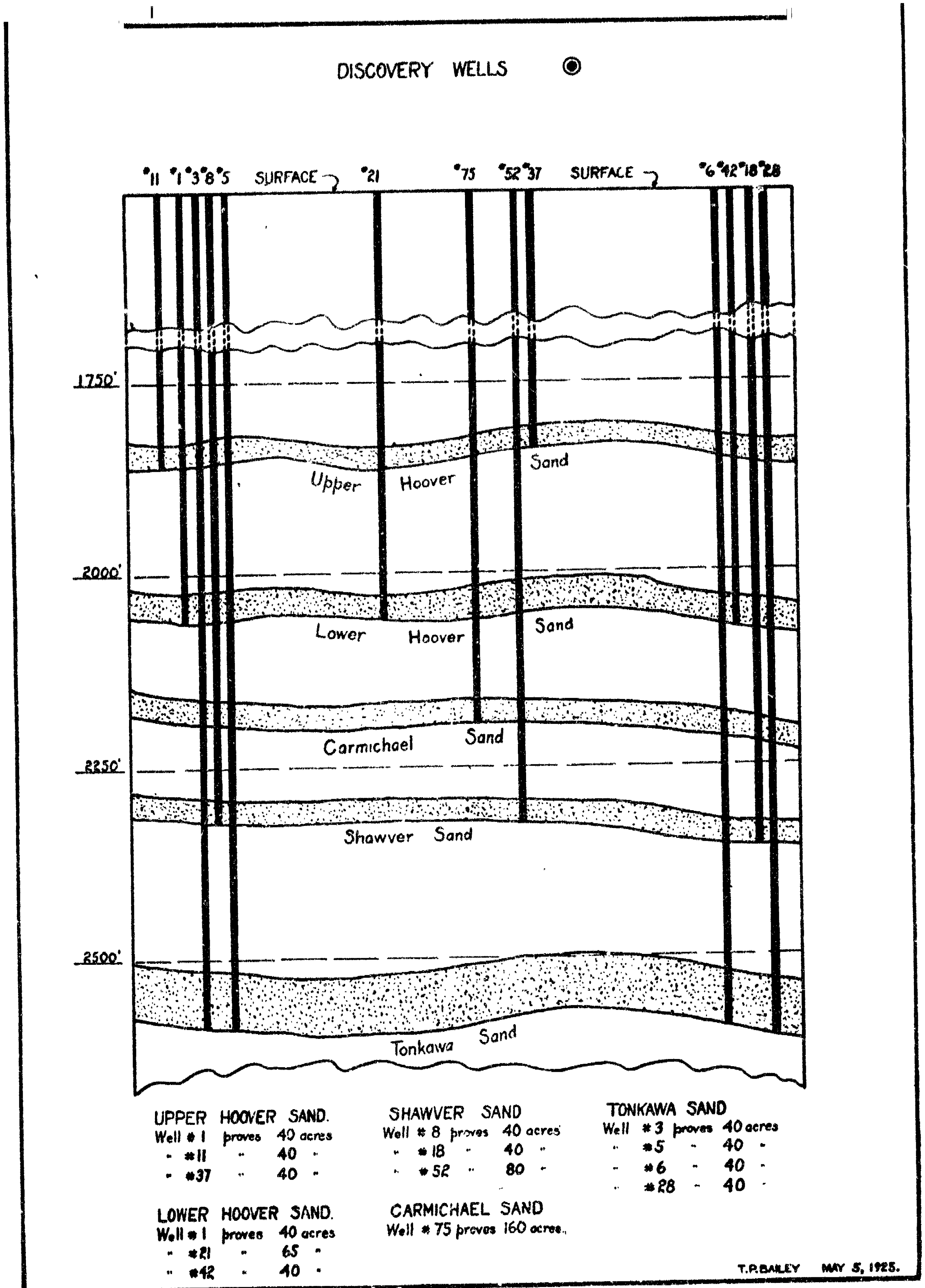
SHAWVER LEASE 160 ACRES NW SEC. 2 T. 24 N. R 1 W.

NOBLE COUNTY OKLAHOMA



DISCOVERY WELLS ◉





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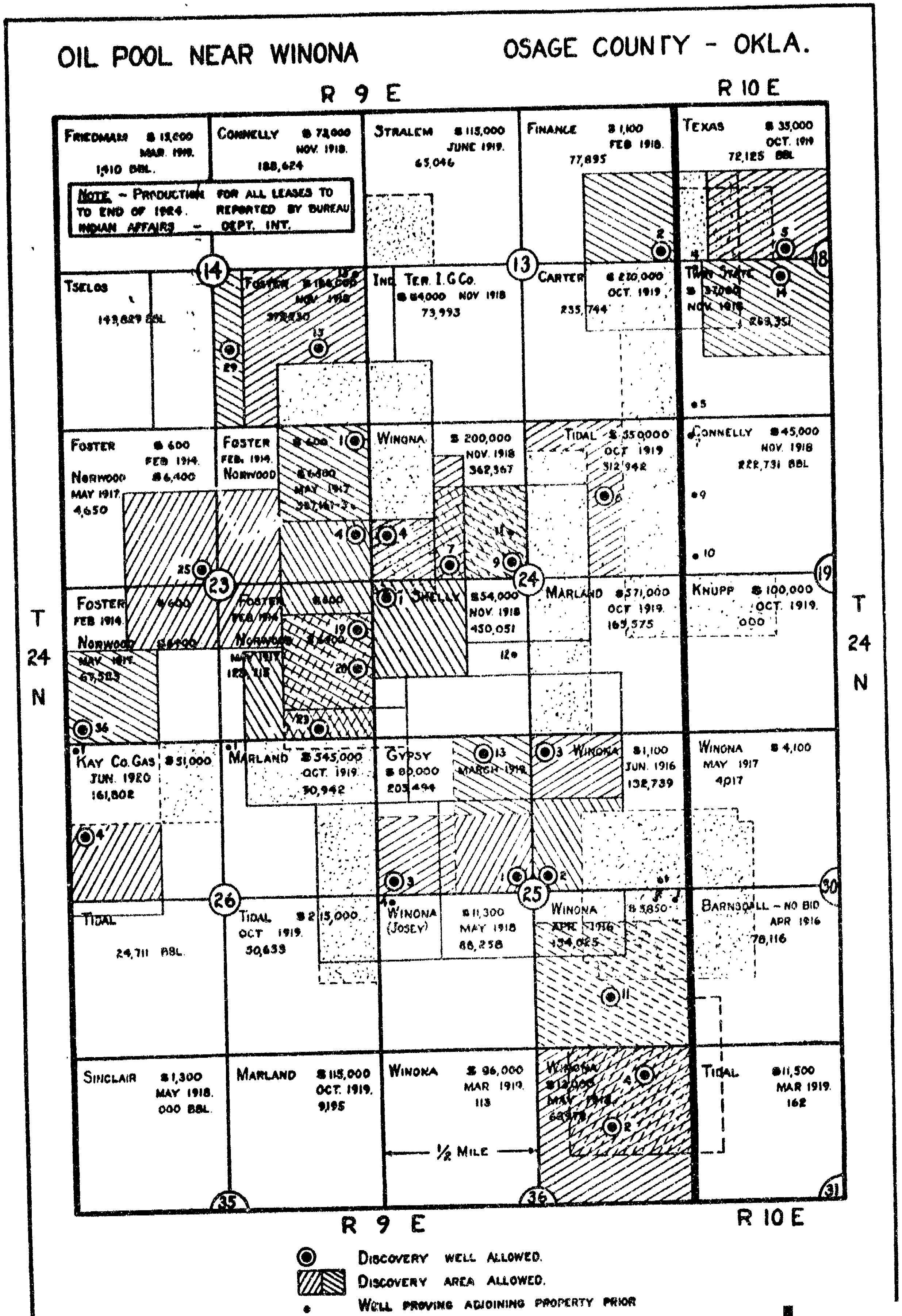
OIL POOL NEAR WINONA
OSAGE COUNTY - OKLA.
R 9 E
R 10 E
T 24 N
FRIEDMAN $ 15,000 MAR. 1919. 1,910 BBL.
CONNELLY $ 73,000 NOV. 1918. 188,624
STRALEM $ 115,000 JUNE 1919. 65,046
FINANCE $ 1,100 FEB 1918. 77,895
TEXAS $ 35,000 OCT. 1919 72,125 BBL
NOTE - PRODUCTION FOR ALL LEASES TO TO END OF 1924. REPORTED BY BUREAU INDIAN AFFAIRS - DEPT. INT.
TSELOS 143,829 BBL
IND. TER. I. G. CO. $ 64,000 NOV 1918 73,993
CARTER $ 220,000 OCT. 1919 235,744
FOSTER $ 600 FEB 1914. NORWOOD $ 6,400 MAY 1917. 4,650
WINONA $ 200,000 NOV. 1918 362,367
TIDAL $ 350,000 OCT 1919 312,942
CONNELLY $ 45,000 NOV. 1918 222,731 BBL.
MARLAND $ 371,000 OCT 1919. 165,575
KNUPP $ 100,000 OCT. 1919. 000
SHELLY $ 54,000 NOV. 1918 450,051
KAY CO. GAS $ 31,000 JUN. 1920 161,802
MARLAND $ 345,000 OCT. 1919. 30,942
GYPSY $ 80,000 205,494
MARCH 1919
WINONA $ 1,100 JUN. 1916 132,739
WINONA $ 4,100 MAY 1917 4017
TIDAL 24,711 BBL.
TIDAL $ 215,000 OCT 1919. 50,633
WINONA (JOSEY) $ 11,300 MAY 1918 88,258
WINONA $ 3,850 APR. 1916 134,025
BARNSDALL - NO BID APR 1916 78,116
SINCLAIR $ 1,300 MAY 1918. 000 BBL.
MARLAND $ 115,000 OCT. 1919. 9,195
WINONA $ 96,000 MAR 1919. 113
WINONA $ 12,000 MAY 1918
TIDAL $ 11,500 MAR 1919. 162
½ MILE
14
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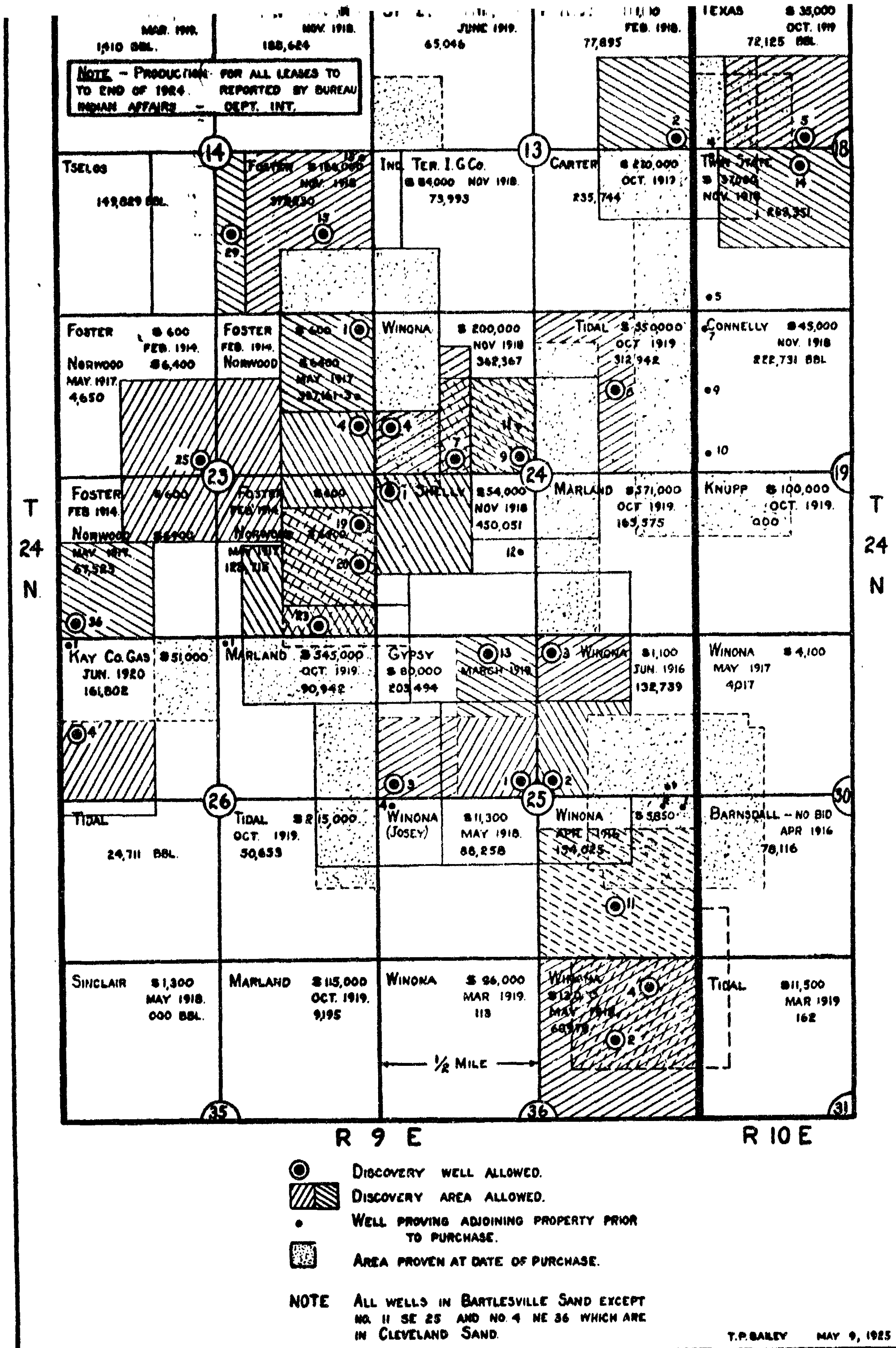
DISCOVERY WELL ALLOWED.
DISCOVERY AREA ALLOWED.
WELL PROVING ADJOINING PROPERTY PRIOR



S. Rept. 27, 69-1. (To face page 41.) No. 1.

TABLE 9.—*Computation of surtax at 1926 rates on undivided 1923 profits of corporations reporting income exceeding $50,000 and which distributed less than 60 per cent of net earnings as cash dividends*

	Undistributed earnings allocated to taxpayer	Per cent to total undistributed earnings	Distribution of undivided profits of corporations reporting income over $50,000 and which distributed less than 60 per cent of net earnings as cash dividends	Surtax rate, per cent	Surtax on undistributed earnings
Under $10,000	$2,797,836	3.159	$83,317,179		
$10,000-$14,000	2,196,189	2.479	65,382,490	1	$653,825
$14,000-$16,000	1,208,362	1.364	35,974,875	2	719,498
$16,000-$18,000	1,256,640	1.419	37,425,475	3	1,122,764
$18,000-$20,000	1,316,602	1.486	39,192,570	4	1,567,703
$20,000-$22,000	1,377,620	1.555	41,012,413	5	2,050,621
$22,000-$24,000	1,430,664	1.615	42,594,886	6	2,555,693
$24,000-$26,000	1,427,488	1.612	42,515,762	7	2,976,103
$26,000-$28,000	1,437,313	1.623	42,805,882	8	3,424,471
$28,000-$30,000	1,434,342	1.619	42,700,384	9	3,843,035
$30,000-$34,000	2,829,191	3.194	84,240,288	10	8,424,029
$34,000-$36,000	1,402,615	1.584	41,777,275	11	4,595,500
$36,000-$38,000	1,389,555	1.569	41,381,657	12	4,965,799
$38,000-$42,000	2,714,711	3.065	80,837,972	13	10,508,936
$42,000-$46,000	2,646,720	2.988	78,807,132	14	11,032,998
$46,000-$50,000	2,618,549	2.956	77,963,147	15	11,694,472
$50,000-$60,000	6,215,442	7.017	185,070,163	16	29,611,226
$60,000-$70,000	5,508,818	6.219	164,023,278	17	27,883,957
$70,000-$80,000	4,853,881	5.480	144,532,491	18	26,015,848
$80,000-$100,000	8,210,724	9.270	244,492,007	19	46,453,481
$100,000 and over	34,302,973	38.727	1,021,406,898	20	204,281,380
Total	88,576,215	100.000	2,637,454,225	[1] 15.332	404,381,339

[1] Average.

The table facing this page is a summary of individual incomes and deductions for the period 1916 to 1924, inclusive. These figures are taken from the "Statistics of income" published each year by the Bureau of Internal Revenue.

JAMES COUZENS.
A. A. JONES.
WILLIAM H. KING.

Summary of income, 1916 to 1924, inclusive

NONTAXABLE

Year	Returns		Wages and salaries			Business			Partnerships			Profits on sales [1]			Rents and royalties		
	Number	Per cent of increase or decrease	Amount	Per cent of total income	Per cent of increase or decrease	Amount	Per cent of total income	Per cent of increase or decrease	Amount	Per cent of total income	Per cent of increase or decrease	Amount	Per cent of total income	Per cent of increase or decrease	Amount	Per cent of total income	Per cent of increase or decrease
1918	1,032,251	....	$1,396,820,383	63.49	....	$377,233,541	17.15	....	$47,325,736	2.15	....	$18,955,026	0.86	....	$113,978,587	5.18	....
1919	1,101,579	6.72	1,503,939,896	63.38	7.67	416,854,386	17.57	10.50	53,987,412	2.28	14.08	31,992,844	1.35	68.78	111,015,490	4.68	−2.60
1920	1,741,634	58.10	2,761,460,584	72.73	83.62	431,768,361	11.37	3.58	62,267,482	1.64	15.34	47,864,678	1.26	49.67	146,690,764	3.86	32.14
1921	3,072,191	76.39	5,317,663,350	69.41	92.57	804,400,22[illegible]	10.50	86.30	187,309,02[illegible]	2.44	20.08	96,791,159	1.26	102.13	400,422,149	5.23	172.97
1922	3,106,232	1.11	5,074,672,305	67.45	−4.58	947,482,986	12.59	17.79	201,020,098	2.67	7.32	107,969,163	1.44	11.15	380,270,033	5.05	−5.03
1923	3,428,200	10.37	5,388,222,420	60.19	6.19	1,706,201,601	19.06	80.08	267,566,710	2.99	33.10	123,146,438	1.38	14.06	560,472,723	6.26	47.39
1924 [2]	3,208,447	−6.41	5,01[illegible],649,759	59.93	−[illegible].38	1,595,431,115	18.96	−6.49	251,157,782	2.98	−6.14	116,485,300	1.38	−5.41	525,638,758	6.26	−6.22
LESS THAN $5,000																	
1916	....	....	$418,759,074	46.87	....	$255,357,921	26.70	....	....	....	....	....	....	....	$127,061,137	13.29	....
1917	1,399,470	....	1,653,047,587	40.22	313.61	1,802,640,703	39.12	605.92	$193,378,511	4.20	....	$100,241,717	2.18	....	343,475,080	7.45	170.32
1918	2,913,901	108.21	4,766,752,413	60.54	157.15	1,598,821,950	20.31	−11.31	253,735,393	3.22	31.21	84,821,823	1.08	−15.38	475,227,238	6.04	38.36
1919	3,573,522	22.64	6,303,746,792	64.61	32.21	1,716,896,151	17.60	7.38	351,370,742	3.60	38.48	290,087,755	2.97	241.98	462,377,876	4.74	−2.70
1920	4,836,748	35.35	9,141,597,111	73.63	45.02	1,375,717,799	10.99	−19.87	377,002,615	3.01	7.31	348,664,752	2.79	20.19	448,854,765	3.59	−2.92
1921	3,064,379	−36.43	[illegible]	73.96	−38.0[illegible]	745,878,353	9.02	−45.78	250,3[illegible]	3.2[illegible]	−33.[illegible]	[illegible],611,468	1.44	−67.99	37[illegible],003,328	4.00	−20.55
1922	3,695,043	1.09	5,098,575,348	70.69	.64	[illegible]2,559,547	10.93	18.32	309,472,182	3.83	23.6[illegible]	[illegible]1,777,12[illegible]	1.79	29.72	361,446,239	4.52	2.20
1923	3,648,100	17.87	5,[illegible]	54.70	[illegible]	1,978,758,040	18.87	121.95	486,221,845	4.[illegible]	7.1[illegible]	281,731,458	2.71	94.00	775,355,891	7.28	107.27
1924 [2]	3,408,447	−6.57	5,[illegible],816,200	51.70	−6.57	1,828,564,581	18.86	−6.65	[illegible]	[illegible]	−[illegible]48	263,111,345	2.72	−6.50	765,021,859	7.27	−0.67
$5,000–$10,000																	
1916	150,553	....	$552,916,528	36.38	....	$497,354,27[illegible]	32.60	....	....	....	....	....	....	....	$165,868,818	10.91	....
1917	270,666	79.78	660,884,433	33.87	19.53	530,770,260	27.20	7.15	$128,969,689	6.61	....	$52,909,852	2.71	....	126,391,211	6.48	−23.80
1918	319,356	17.99	849,459,472	33.51	28.53	650,038,458	25.67	22.47	237,528,657	9.38	84.18	69,021,107	2.73	30.45	179,298,821	7.08	41.86
1919	438,851	37.42	1,277,528,172	36.59	50.37	908,454,135	26.03	39.75	321,776,001	9.22	35.46	218,506,729	6.26	216.58	186,529,660	5.34	4.03
1920	455,442	3.78	1,494,713,942	41.34	17.02	682,675,071	18.88	−24.85	315,390,492	8.72	−1.98	285,348,114	7.89	30.59	183,548,576	5.08	−1.60
1921	353,247	−22.44	1,542,1[illegible]	46.9[illegible]	[illegible]	402,162,466	13.06	−41.09	245,779,677	8.[illegible]	−22.07	102,815,373	3.50	−63.97	171,850,952	6.01	−6.37
1922	383,368	8.53	1,[illegible]	[illegible]	7.54	491,522,459	16.03	22.22	245,629,031	8.01	−.05	148,491,519	4.84	44.43	190,973,026	6.23	11.13
1923	393,694	2.69	1,407,206,5[illegible]	44.61	5.24	492,520,455	15.61	.20	259,884,375	8.24	5.80	143,517,274	4.55	−3.35	194,637,790	6.17	1.92
1924 [1]	425,087	7.97	1,480,698,621	44.47	5.18	622,609,716	18.71	26.41	312,946,170	9.40	20.42	[illegible],377,352	5.87	36.14	225,020,865	6.76	15.61
$10,000–$40,000																	
1916	99,063	....	$555,619,785	22.58	....	$792,527,279	32.20	....	....	....	....	....	....	....	$200,572,583	8.15	....
1917	135,806	37.17	727,772,412	28.20	30.98	349,262,611	13.56	−55.93	$190,770,062	7.41	....	$75,703,781	2.94	....	130,477,855	5.07	−34.95
1918	138,562	2.10	879,156,850	31.23	20.80	344,279,688	12.23	−1.43	309,461,756	10.99	62.40	77,917,969	2.77	3.07	139,982,395	4.97	7.28
1919	191,664	38.22	1,198,256,480	30.84	36.30	581,659,263	14.97	68.95	507,548,905	13.06	64.01	257,196,217	6.62	230.09	174,299,929	4.49	24.52
1920	202,109	5.45	1,427,632,946	33.27	19.14	525,329,163	12.24	−9.68	523,019,553	12.19	3.05	264,762,687	6.17	2.94	181,388,491	4.22	4.07
1921	155,239	−23.19	1,171,865,802	35.11	−17.92	318,664,750	9.55	−39.34	[illegible]90,458,715	11.70	−2[illegible]	114,396,741	3.43	−56.79	178,558,952	5.35	−1.56
1922	178,837	15.20	1,184,564,507	31.82	1.07	387,248,817	10.41	21.52	381,176,751	10.24	−2.37	244,242,050	6.56	113.50	199,275,425	5.35	11.60
1923	203,161	13.60	1,357,964,744	32.04	14.66	444,809,969	10.49	14.86	421,925,181	[illegible]	11.18	261,667,792	6.17	7.13	216,873,518	5.12	8.82
1924 [2]	225,129	10.81	1,459,209,869	31.41	5.99	505,578,097	11.03	13.66	457,910,767	9.99	7.72	404,551,829	8.83	54.72	240,076,360	5.57	13.46
$40,000–$100,000																	
1916	16,063	....	$156,141,981	12.75	....	$393,261,273	32.12	....	....	....	....	....	....	....	$70,039,033	5.72	....
1917	19,526	21.56	243,089,750	19.97	55.68	99,920,833	8.08	−74.59	$106,877,615	8.65	....	$36,633,783	2.96	....	42,983,070	3.48	−38.66
1918	16,445	−15.78	251,780,863	22.17	3.58	83,868,894	7.39	−16.06	161,125,890	14.19	50.76	21,076,814	1.85	−42.52	36,763,656	3.24	−14.43
1919	21,618	31.46	324,332,231	21.71	28.81	151,326,348	10.13	80.43	270,015,055	18.07	67.58	96,257,758	6.44	357.13	48,473,761	3.25	31.85
1920	20,362	−5.81	340,076,954	22.62	4.85	127,395,790	8.47	−15.81	249,257,852	16.58	−7.69	50,762,995	3.38	−47.26	54,881,549	3.65	13.22
1921	14,768	−27.47	247,804,248	22.72	−27.11	66,156,857	6.06	−48.07	169,488,443	15.53	−32.00	28,416,397	2.61	−44.02	46,203,761	4.23	−15.81
1922	19,970	35.22	278,887,752	19.95	12.52	95,459,891	6.83	44.29	168,141,580	12.03	−.79	125,758,037	9.00	342.55	55,294,638	3.96	19.68
1923	20,924	4.78	292,055,754	19.92	4.72	96,655,653	6.59	1.25	159,003,024	10.84	−5.44	124,358,911	8.48	−1.11	57,833,137	3.94	4.5[illegible]
1924 [2]	25,677	22.72	350,823,590	20.06	20.12	105,546,472	6.63	9.20	178,998,915	10.25	12.58	205,423,615	11.74	65.19	63,118,609	3.61	9.1[illegible]
$100,000–$300,000																	
1916	5,337	....	$92,964,454	8.98	....	$340,178,477	32.83	....	....	....	....	....	....	....	$40,592,233	3.92	....
1917	5,649	5.85	119,507,75[illegible]	12.99	28.55	52,827,065	5.74	−84.47	$95,389,445	10.37	....	$29,521,556	3.21	....	24,591,452	2.67	−39.4[illegible]
1918	3,872	−31.46	96,702,657	13.89	−19.25	47,556,022	6.84	−9.98	127,205,976	18.30	33.35	11,391,254	1.64	−61.41	16,703,675	2.40	−32.[illegible]
1919	4,847	25.18	119,948,406	13.45	24.30	73,660,080	8.26	54.89	220,115,680	24.68	73.04	50,178,505	5.63	340.50	23,021,880	2.58	37.8[illegible]
1920	3,254	−32.87	85,578,571	13.48	−28.65	45,124,685	7.11	−38.74	127,322,901	20.05	−42.16	14,175,933	2.23	−71.75	23,019,724	3.63	−[illegible]
1921	2,106	−35.28	59,132,104	14.26	−30.90	29,691,526	4.99	−34.15	71,746,058	17.30	−43.65	6,402,364	1.54	−54.84	15,671,321	3.78	−31.9[illegible]
1922	3,494	65.91	78,870,616	11.79	30.00	26,420,307	4.05	27.69	87,974,365	13.49	22.62	94,473,502	14.49	1,375.60	23,392,504	3.59	49.2[illegible]
1923	3,640	4.18	82,849,002	12.37	7.78	23,512,757	3.51	−11.00	67,827,375	10.13	−22.90	98,103,097	14.65	3.84	22,498,817	3.36	−3.[illegible]
1924 [2]	4,921	35.19	112,693,148	13.03	36.02	26,294,699	3.04	11.83	89,815,387	10.38	32.42	157,471,507	18.20	60.52	27,272,001	3.15	21.2[illegible]

NONTAXABLE

les	Business			Partnerships			Profits on sales [1]			Rents and royalties			Interest			Partially exempt Government obligations		
Per cent of increase or decrease	Amount	Per cent of total income	Per cent of increase or decrease	Amount	Per cent of total income	Per cent of increase or decrease	Amount	Per cent of total income	Per cent of increase or decrease	Amount	Per cent of total income	Per cent of increase or decrease	Amount	Per cent of total income	Per cent of increase or decrease	Amount	Per cent of total income	Per cent of increase or decrease
----------	$377,233,541	17.15	----------	$47,325,736	2.15	----------	$18,955,026	0.86	----------	$113,978,587	5.18	----------	$97,885,250	4.45	----------	----------	----------	----------
7.67	416,854,380	17.57	10.50	53,987,442	2.28	14.08	31,992,844	1.35	68.78	111,015,490	4.68	−2.60	105,478,206	4.44	7.76	$8,239	----------	----------
83.62	431,768,361	11.37	3.58	62,267,482	1.64	15.34	47,864,678	1.26	49.67	146,690,764	3.86	32.14	159,818,789	4.21	51.52	----------	----------	----------
92.57	804,400,222	10.50	86.30	187,309,025	2.44	20.68	96,791,159	1.26	102.13	400,422,149	5.23	172.07	422,618,658	5.52	164.44	5,488,651	0.07	----------
−4.58	947,482,986	12.59	17.79	201,020,098	2.67	7.32	107,969,163	1.44	11.15	380,270,033	5.05	−5.03	428,720,283	5.70	1.44	2,534,668	.03	−53.25
6.19	1,706,201,601	19.06	80.08	267,566,710	2.99	33.10	123,146,438	1.38	14.06	560,472,723	6.26	47.39	467,205,219	5.22	6.98	8,353,915	.09	229 98
−6.38	1,595,431,115	18.96	−6.49	251,137,582	2.98	−6.14	116,485,300	1.38	−5.41	525,638,758	6.26	−6.22	449,469,818	5.34	−3.80	----------	----------	−100.00
								LESS THAN $5,000										
----------	$255,357,921	26.70	----------	----------	----------	----------	----------	----------	----------	$127,061,137	13.29	----------	$87,610,655	9.16	----------	----------	----------	----------
313.61	1,802,640,703	39.12	605.92	$193,378,514	4.20	----------	$160,211,717	2.18	----------	343,475,680	7.45	170.32	114,235,741	2.48	30.39	----------	----------	----------
157.15	1,598,824,950	20.31	−11.31	253,735,393	3.22	31.21	84,821,823	1.08	−15.38	475,227,238	6.04	38.36	506,414,778	6.43	343.31	----------	----------	----------
32.24	1,716,896,151	17.60	7.38	351,370,742	3.60	38.48	290,087,755	2.97	241.98	462,377,876	4.74	−2.70	455,237,154	4.67	−10.11	$798,227	----------	----------
45.02	1,375,717,799	10.99	−19.87	377,062,615	3.01	7.31	348,664,752	2.79	20.19	448,854,765	3.59	−2.92	640,037,501	5.11	40.59	1,117,669	----------	40.02
−38.01	745,578,353	9.62	−45.78	250,306,536	3.23	−33.62	111,611,468	1.41	−67.99	356,603,328	4.60	−20.55	488,029,311	6.30	−23.75	1,224,510	0.02	9.56
.61	882,539,547	10.93	18.32	309,172,181	3.83	23.65	114,777,129	1.79	29.72	364,446,290	4.52	2.20	526,411,250	6.52	7.86	771,630	.01	−36.98
−.56	1,958,758,040	18.87	121.95	486,221,815	4.68	7.11	281,731,458	2.71	91.60	775,395,891	7.28	107.27	942,598,044	9.08	79.06	5,198,871	.05	573.75
−6.57	1,828,564,581	18.86	−6.65	454,096,645	4.89	−6.48	263,114,745	2.72	−6.50	705,021,899	7.27	−6.67	886,314,546	9.14	−5.97	----------	----------	−100.00
								$5,000–$10,000										
----------	$495,354,234	32.60	----------	----------	----------	----------	----------	----------	----------	$165,868,818	10.91	----------	$161,238,275	10.61	----------	----------	----------	----------
19.53	530,770,260	27.20	7.15	$128,969,619	6.61	----------	$52,909,852	2.71	----------	126,391,211	6.48	−23.80	171,907,269	8.81	6.62	----------	----------	----------
28.53	650,038,458	25.67	22.47	237,525,657	9.38	84.18	69,021,107	2.73	30.45	179,298,821	7.08	41.86	220,602,275	8.71	28.33	----------	----------	----------
50.57	908,454,138	26.03	39.75	321,776,001	9.22	35.46	218,506,729	6.26	216.58	186,529,660	5.34	4.03	241,981,551	6.93	9.69	$13,498,714	0.39	----------
17.02	682,673,071	18.88	−24.85	315,390,492	8.72	−1.98	285,348,114	7.89	30.59	183,548,576	5.08	−1.60	252,477,275	6.98	4.34	16,197,435	.45	19.94
−10.19	402,162,465	14.06	−41.09	245,779,077	8.59	−22.07	102,815,373	3.59	−63.97	171,850,952	6.01	−6.37	236,284,018	8.26	−6.41	10,107,083	.35	−37.57
1.54	491,532,459	9.03	22.22	245,629,031	8.01	−.06	138,491,519	4.81	44.43	190,973,026	6.23	11.13	297,860,515	9.71	26.06	6,541,104	.21	−35.28
3.24	492,520,455	15.61	.20	259,884,355	8.24	7.80	113,517,253	4.55	−3.35	194,637,790	6.17	1.92	321,664,368	10.29	9.00	5,027,181	.16	−23.14
5.18	622,609,716	18.71	26.41	312,916,170	9.40	20.42	195,577,352	5.87	36.14	225,620,805	6.76	15.61	267,829,490	8.05	−17.51	----------	----------	−100.00
								$10,000–$40,000										
----------	$792,527,279	32.20	----------	----------	----------	----------	----------	----------	----------	$200,572,583	8.15	----------	$331,020,283	13.45	----------	----------	----------	----------
30.98	349,262,611	13.58	−55.93	$196,550,062	7.41	----------	$75,593,781	2.94	----------	130,477,855	5.07	−34.95	279,092,021	10.85	−15.69	----------	----------	----------
20.80	344,279,688	12.23	−1.43	309,461,756	10.99	62.40	77,917,909	2.77	3.07	139,982,395	4.97	7.28	283,889,066	10.08	1.72	----------	----------	----------
36.30	581,659,263	11.97	68.95	507,548,905	13.06	64.01	257,106,217	6.62	230.09	174,299,929	4.49	24.52	338,993,754	8.73	19.41	$22,696,282	0.58	----------
19.14	525,329,163	12.71	−9.68	523,019,533	12.19	3.05	264,762,887	6.17	2.94	181,388,491	4.22	4.07	358,312,915	8.35	5.70	27,398,634	.64	20.72
−17.92	318,664,790	9.75	−39.34	390,438,715	11.70	−23.37	114,396,713	3.43	−56.79	178,558,952	5.35	−1.56	328,516,754	9.84	−8.32	17,595,414	.53	−35.78
1.07	387,248,817	10.41	21.52	381,170,751	10.24	−2.37	244,292,050	6.56	113.50	199,275,425	5.35	11.60	448,476,175	12.05	36.52	13,357,150	.36	−24.09
14.66	444,809,909	10.49	14.86	424,929,481	10.03	11.48	261,665,792	6.17	7.13	216,873,318	5.12	8.83	495,749,907	11.70	10.54	13,616,295	.32	1.94
5.99	505,578,097	11.63	13.66	457,910,707	9.59	7.76	404,851,829	8.83	54.72	216,656,360	5.37	13.46	495,670,714	10.82	−.02	11,[illegible]9,003	.32	8.39
								$40,000–$100,000										
----------	$393,261,273	32.12	----------	----------	----------	----------	----------	----------	----------	$70,039,033	5.72	----------	$176,495,864	14.41	----------	----------	----------	----------
55.68	99,920,833	8.08	−74.59	$106,877,615	8.65	----------	$36,633,783	2.96	----------	42,963,070	3.48	−38.66	140,472,512	11.37	−20.37	----------	----------	----------
3.58	83,868,894	7.39	−16.06	161,125,890	14.19	50.76	21,056,814	1.85	−42.52	36,763,656	3.24	−14.43	129,053,423	11.37	−8.13	----------	----------	----------
28.81	151,326,348	10.13	80.43	270,015,055	18.07	67.78	96,257,758	6.44	357.13	48,473,761	3.25	31.85	144,156,938	9.65	11.70	$9,631,093	0.64	----------
4.85	127,395,790	8.47	−15.81	249,257,852	16.58	−7.69	50,762,995	3.38	−47.26	54,881,549	3.65	13.22	140,714,645	9.37	−2.39	9,496,636	.63	−1.40
−27.11	66,156,857	6.06	−48.07	169,488,443	15.53	−32.00	28,416,397	2.61	−44.02	46,203,761	4.23	−15.81	110,016,990	10.08	−21.82	6,954,728	.64	−26.77
12.52	95,459,891	6.83	44.29	168,141,580	12.03	−.79	125,758,037	9.00	342.55	55,294,638	3.96	19.68	176,720,713	12.65	60.63	6,191,216	.44	−10.98
4.72	96,655,653	6.59	1.25	159,003,024	10.84	−5.41	124,358,911	8.48	−1.11	57,833,137	3.94	4.59	170,955,019	11.66	−3.26	7,059,485	.48	14.02
20.12	105,546,452	6.03	9.20	178,998,915	10.23	12.58	205,423,615	11.74	65.19	63,118,609	3.61	9.14	202,470,631	11.58	18.43	8,203,919	.47	16.21
								$100,000–$300,000										
----------	$340,178,477	32.83	----------	----------	----------	----------	----------	----------	----------	$40,592,233	3.92	----------	$1[illegible]8,870,428	15.34	----------	----------	----------	----------
23.55	52,827,665	5.74	−84.47	$95,389,445	10.57	----------	$29,521,356	3.21	----------	24,591,452	2.67	−39.42	119,539,786	12.99	−24.76	----------	----------	----------
−19.25	47,556,022	6.84	−9.98	127,205,976	18.30	33.35	11,391,254	1.64	−61.41	16,703,675	2.40	−32.08	91,030,392	13.10	−23.85	----------	----------	----------
24.30	73,660,080	8.26	54.89	220,115,680	24.68	73.04	50,178,505	5.63	340.50	23,021,880	2.58	37.83	91,467,182	10.26	.48	$2,709,043	0.37	----------
−28.65	45,124,685	7.11	−38.74	127,322,901	20.05	−42.16	14,175,933	2.23	−71.75	23,018,724	3.63	−.01	62,111,809	9.78	−32.09	4,777,368	.75	−45.14
−30.90	20,691,526	4.99	−54.15	71,746,058	17.30	−43.65	6,402,364	1.54	−54.84	15,671,321	3.78	−31.92	39,619,237	9.56	−36.21	3,751,427	.90	−21.48
30.00	26,420,307	4.05	27.69	87,974,365	13.49	22.62	94,473,502	14.49	1,375.60	23,392,504	3.59	49.27	80,181,186	12.30	102.38	2,521,390	.39	−32.79
7.78	23,512,757	3.51	−11.00	67,827,375	10.13	−22.90	98,103,097	14.65	3.84	22,498,817	3.36	−3.82	73,159,120	10.92	−8.76	2,699,355	.40	7.06
56.02	26,294,699	3.04	11.83	89,815,387	10.38	32.42	157,471,807	18.20	60.52	27,272,001	3.15	21.22	85,239,017	9.85	16.51	3,901,725	.45	44.54
								$300,000 AND OVER										
----------	$365,584,201	31.71	----------	----------	----------	----------	----------	----------	----------	$39,668,853	3.44	----------	$165,733,900	14.38	----------	----------	----------	----------
7.00	29,990,674	3.80	−91.80	$59,921,390	7.59	----------	$23,270,128	2.95	----------	16,444,131	2.08	−58.55	111,468,127	14.12	−32.74	----------	----------	----------
−38.18	22,553,643	4.57	−24.80	78,521,014	15.90	31.04	8,018,771	1.62	−65.54	13,725,294	2.78	−16.53	74,610,507	15.11	−33.07	----------	----------	
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]											

1917	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1918	2,913,901	108.21	4,766,752,413	60.54	157.15	1,598,824,950	20.31	−11.31	253,735,303	3.22	31.21	84,824,823	1.08	−15.38	475,227,238	6.04	38.36	506,414,
1919	3,573,522	22.64	6,303,746,792	64.61	32.24	1,716,896,151	17.60	7.38	351,370,742	3.60	38.48	290,087,755	2.97	241.98	462,377,876	4.74	−2.70	455,237,
1920	4,836,748	35.35	9,141,397,111	73.03	45.02	1,375,717,799	10.99	−19.87	377,062,615	3.01	7.31	348,664,752	2.79	20.19	448,854,765	3.59	−2.92	640,037,
1921	3,064,379	−36.43	5,663,986,009	73.06	−38.04	745,878,353	9.02	−45.78	250,306,336	3.23	−33.62	111,641,468	1.44	−67.99	356,603,328	4.60	−20.55	488,029,
1922	3,095,043	1.00	5,698,573,348	70.60	.61	882,539,547	10.93	18.32	309,472,181	3.83	23.63	144,777,129	1.79	29.72	364,446,290	4.52	2.20	528,411,
1923	3,648,140	17.87	5,678,003,600	54.70	−.36	1,958,758,640	18.87	121.95	486,221,845	4.[illegible]8	57.11	281,734,458	2.71	94.60	755,395,891	7.28	107.27	942,598,
1924 [2]	3,408,447	−6.57	5,304,816,260	54.70	−6.57	1,828,564,581	18.86	−6.65	454,696,645	4.[illegible]9	−6.48	263,411,545	2.72	−6.50	705,021,899	7.27	−6.67	886,314,

$5,000–$10,000

1916	150,553	....	$552,916,528	30.38	....	$495,354,234	32.60	....	....	....	....	....	....	....	$165,868,818	10.91	....	$161,238,2
1917	270,666	79.78	660,884,433	33.87	19.53	530,770,260	27.20	7.15	$128,969,639	6.61	....	$72,909,852	2.71	....	126,391,211	6.48	−23.80	171,907,2
1918	319,356	17.99	849,459,472	33.54	28.53	650,038,458	25.67	22.47	237,525,657	9.38	84.18	69,021,107	2.73	30.45	179,298,821	7.08	41.86	220,602,
1919	438,851	37.42	1,277,328,172	36.59	50.37	908,454,138	26.03	39.75	321,776,001	9.22	35.46	218,506,729	6.26	216.58	186,529,600	5.34	4.03	241,981,
1920	455,442	3.78	1,494,713,942	41.34	17.02	682,675,071	18.88	−24.85	315,390,492	8.72	−1.98	285,346,114	7.89	30.59	183,548,576	5.08	−1.60	252,477,2
1921	353,247	−22.44	1,342,428,626	46.95	−10.19	402,162,405	14.06	−41.09	245,779,077	6.59	−22.07	102,815,373	3.59	−63.97	171,850,952	6.01	−6.37	236,284,
1922	383,368	8.53	1,363,072,17[illegible]	44.45	1.54	491,532,459	16.03	22.22	245,629,031	8.01	−.06	118,491,819	4.84	44.43	190,973,026	6.23	11.13	297,860,5
1923	393,694	2.69	1,407,276,54[illegible]	44.61	3.24	492,520,455	15.61	.20	259,884,355	8.24	5.80	114,51[illegible],254	4.55	−3.35	191,637,790	6.17	1.02	324,664,2
1924 [1]	425,087	7.97	1,480,098,621	44.47	5.18	622,609,716	18.71	26.41	312,946,170	9.40	20.42	155,377,332	5.87	36.14	225,620,805	6.76	15.61	267,829,

$10,000–$40,000

1916	99,003	....	$555,619,785	22.58	....	$702,527,279	32.20	....	....	....	....	....	....	....	$200,572,583	8.15	....	$331,020,2
1917	135,806	37.17	727,772,412	28.50	30.98	349,262,611	13.58	−55.93	$190,550,062	7.41	....	$75,593,781	2.94	....	130,477,8[illegible]5	5.07	−34.95	279,092,
1918	138,562	2.10	879,156,850	31.23	20.80	344,279,688	12.23	−1.43	309,461,756	10.99	62.40	77,917,909	2.77	3.07	139,982,395	4.97	7.28	283,889,
1919	191,664	38.22	1,198,256,480	30.84	36.30	581,659,263	11.97	68.95	507,548,905	13.06	64.01	257,106,217	6.62	230.09	174,259,929	4.49	24.52	338,993,7
1920	202,109	5.45	1,427,632,946	33.27	19.14	525,329,163	12.24	−9.68	523,019,533	12.19	3.05	264,762,687	6.17	2.94	181,358,491	4.22	4.07	358,312,9
1921	155,230	−23.19	1,171,865,802	25.11	−17.92	318,664,790	9.55	−39.34	400,438,715	11.79	−23.37	114,396,741	3.43	−56.79	178,558,952	5.35	−1.56	328,516,7
1922	178,837	15.20	1,184,364,507	31.82	1.07	387,248,817	10.41	21.52	381,170,751	10.24	−2.37	244,242,030	6.56	113.50	199,275,425	5.35	11.60	448,476,1
1923	203,161	13.60	1,357,964,744	32.04	14.66	444,809,969	10.49	14.86	424,929,481	10.03	11.48	261,667,592	6.17	7.13	216,873,318	5.12	8.83	495,749,
1924 [2]	225,129	10.81	1,439,209,869	31.41	5.99	505,578,007	11.03	13.66	457,910,707	9.59	7.76	404,851,829	8.83	54.72	246,056,360	5.37	13.46	495,670,7

$40,000–$100,000

1916	16,063	....	$156,141,981	12.75	....	$393,261,273	32.12	....	....	....	....	....	....	....	$70,039,033	5.72	....	$176,495,8
1917	19,526	21.56	243,089,759	19.67	55.68	99,920,833	8.08	−74.59	$106,877,615	8.65	....	$36,633,783	2.96	....	42,963,070	3.48	−38.66	140,472,5
1918	16,445	−15.78	251,786,863	22.17	3.58	83,868,892	7.39	−16.06	161,125,890	14.19	50.76	21,056,811	1.85	−42.52	36,763,656	3.24	−14.43	129,053,4
1919	21,618	31.46	324,332,231	21.71	28.81	151,326,348	10.13	80.43	270,015,055	18.07	67.58	96,257,758	6.44	357.13	48,473,761	3.25	31.85	14[illegible],156,
1920	20,362	−5.81	340,036,954	22.62	4.85	127,395,790	8.47	−15.81	249,257,852	16.58	−7.69	50,762,995	3.38	−47.26	54,881,549	3.65	13.22	146,714,3
1921	14,768	−27.47	247,804,248	22.72	−27.11	66,156,857	6.06	−48.07	169,488,443	15.53	−32.00	28,416,397	2.61	−44.02	46,203,761	4.23	−15.81	110,016,6
1922	19,970	35.22	278,887,752	19.95	12.52	95,459,891	6.83	44.29	168,141,580	12.06	−.79	125,758,037	9.00	342.55	55,294,638	3.96	19.68	176,720,7
1923	20,924	4.78	292,073,774	19.92	4.72	96,655,655	6.59	1.25	159,003,024	10.84	−5.44	124,358,911	8.48	−1.11	57,833,137	3.94	4.59	170,955,
1924 [2]	25,677	22.72	350,823,590	20.06	20.12	105,546,452	6.03	9.20	178,998,915	10.25	12.58	205,423,615	11.74	65.19	63,118,609	3.61	9.14	202,470,0

$100,000–$300,000

1916	5,337	....	$92,904,454	8.98	....	$340,178,477	32.83	....	....	....	....	....	....	....	$40,592,233	3.92	....	$158,870,
1917	5,649	5.85	119,507,759	12.99	28.55	52,827,665	5.74	−84.47	$95,389,445	10.37	....	$29,521,356	3.21	....	24,591,452	2.67	−39.42	119,539,7
1918	3,872	−31.46	96,702,657	13.89	−19.25	47,556,022	6.84	−9.98	127,205,976	18.30	33.35	11,391,254	1.64	−61.41	16,703,675	2.40	−32.08	91,030,
1919	4,847	25.18	119,948,406	13.45	24.30	73,660,980	8.26	54.89	220,115,680	24.68	73.04	50,178,505	5.63	340.50	23,021,880	2.58	37.83	91,467,
1920	3,254	−32.87	85,578,571	13.48	−28.67	45,124,685	7.11	−38.74	127,322,901	20.05	−42.16	14,175,933	2.23	−71.75	23,019,724	3.63	−.01	62,111,
1921	2,106	−35.28	59,132,104	14.26	−30.90	20,691,526	4.99	−54.15	71,746,058	17.30	−43.65	6,402,364	1.54	−54.84	15,671,321	3.78	−31.92	39,619,2
1922	3,494	65.91	76,870,616	11.79	30.00	26,420,307	4.05	27.69	87,974,365	13.49	22.62	94,473,502	14.49	1,375.60	23,392,504	3.59	49.27	80,181,
1923	3,640	4.18	82,849,002	12.37	7.78	23,512,757	3.51	−11.00	67,827,375	10.13	−22.90	98,103,097	14.65	3.84	22,498,817	3.36	−3.82	73,159,1
1924 [2]	4,921	35.19	112,693,118	13.03	36.02	26,294,699	3.04	11.83	89,815,387	10.38	32.42	157,471,807	18.20	60.52	27,272,001	3.15	21.22	85,239,

$300,000 AND OVER

1916	1,296	....	$40,686,089	3.52	....	$365,584,201	31.71	....	....	....	....	....	....	....	$39,668,853	3.44	....	$165,753,
1917	1,015	−21.68	43,535,961	2.52	7.00	29,990,674	3.80	−91.80	$59,921,390	7.59	....	$23,270,128	2.95	....	16,441,131	2.08	−58.55	111,468,1
1918	627	−38.23	26,912,912	3.45	−38.18	22,553,643	1.57	−24.80	78,521,014	15.90	31.04	8,018,771	1.62	−65.54	13,725,294	2.78	−16.53	74,610,5
1919	679	8.29	28,140,674	3.15	4.56	28,700,094	5.25	27.25	106,616,418	19.49	35.78	55,144,479	10.08	587.69	13,375,729	2.45	−2.55	60,087,0
1920	395	−41.83	19,553,246	5.90	−30.59	17,546,518	5.30	−38.86	46,908,557	14.17	−56.09	8,943,560	2.70	−83.78	9,039,869	2.73	−32.42	34,276,9
1921	246	−37.72	10,229,626	4.84	−47.63	8,364,453	3.96	−52.33	26,118,654	12.37	−44.32	2,425,171	1.15	−72.88	8,647,419	4.09	−4.34	18,259,
1922	537	118.29	18,172,090	4.13	77.64	9,087,137	2.06	8.61	33,719,341	7.65	29.10	125,639,900	28.53	5,080.66	11,277,082	2.56	30.41	38,158,
1923	542	.93	23,789,361	5.20	30.91	10,574,992	2.3[illegible]	16.37	16,548,158	3.62	−50.92	139,630,878	30.53	11.14	8,568,433	1.87	−24.02	40,490,
1924 [2]	773	42.62	33,785,376	5.88	42.02	5,209,281	.91	−50.74	33,051,006	5.75	99.73	163,551,811	28.44	17.13	12,530,449	2.18	46.24	46,307,

GRAND TOTAL

1916	....	....	$1,846,487,911	22.11	....	$2,642,263,385	31.64	....	....	....	....	....	....	....	$643,802,657	7.71	....	$1,080,870,
1917	1,832,132	....	3,648,437,902	30.21	97.59	2,865,412,746	23.72	8.45	$775,086,665	6.42	....	$318,170,617	2.63	....	684,345,399	5.67	6.30	936,715,
1918	4,425,114	141.52	8,267,391,550	46.59	126.60	3,124,355,196	17.61	9.04	1,214,914,422	6.85	56.75	291,185,704	1.64	−8.48	975,679,666	5.50	42.57	1,403,485,
1919	5,332,760	20.51	10,755,692,651	47.94	30.10	3,877,550,454	17.28	24.11	1,831,430,243	8.16	50.75	999,364,287	4.45	243.20	1,019,094,265	4.54	4.45	1,437,401,
1920	7,259,944	36.14	15,270,373,354	57.21	41.97	3,205,555,387	12.01	−17.33	1,701,229,432	6.37	−7.11	1,020,542,719	3.82	2.12	1,047,423,738	3.92	2.78	1,647,749,
1921	6,662,176	−8.23	13,813,169,165	59.21	−9.54	2,366,318,610	10.14	−26.18	1,341,186,308	5.75	−21.16	462,858,673	1.98	54.65	1,177,957,882	5.05	12.46	1,643,344,
1922	6,787,481	1.88	13,693,992,791	55.06	−.86	2,839,771,144	11.42	20.01	1,427,127,347	5.74	6.41	991,351,580	3.99	114.18	1,224,928,908	4.92	3.90	1,096,528,
1923	7,698,321	13.42	14,230,208,826	48.54	3.92	4,733,033,407	16.14	66.67	1,681,983,948	5.74	17.86	1,172,154,628	4.00	18.24	1,816,280,109	6.19	48.28	2,514,822,
1924 [2]	7,298,481	−5.19	13,766,136,563	47.12	−3.26	4,689,233,941	16.05	−.93	1,778,556,412	6.99	5.74	1,506,576,239	5.16	28.53	1,804,658,881	6.18	−.64	2,433,301,

[1] Including capital net gains.

[2] Returns filed up to Sept. 30, 1925.

[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	-----	[illegible]	[illegible]	-----	[illegible]	7.40	[illegible]	[illegible]	[illegible]	[illegible]	-----	-----	-----
60.54	157.15	1,598,824,950	20.31	−11.31	253,735,393	3.22	31.21	84,824,823	1.08	−15.38	475,227,238	6.04	38.36	506,414,778	6.43	343.31	-----	-----	-----
64.61	32.24	1,716,896,151	17.60	7.38	351,370,742	3.60	38.48	290,087,755	2.97	241.98	462,377,876	4.74	−2.70	455,237,154	4.67	−10.11	$798,227	-----	-----
73.03	45.02	1,375,717,799	10.99	−19.87	377,062,615	3.01	7.31	348,664,752	2.79	20.19	448,854,765	3.59	−2.92	640,037,501	5.11	40.59	1,117,669	-----	40.02
73.06	−38.04	745,878,353	9.62	−45.78	250,306,336	3.23	−33.62	111,611,468	1.44	−67.99	350,603,328	4.60	−20.55	488,029,311	6.30	−23.75	1,224,510	0.02	9.56
70.60	.61	892,530,547	10.93	18.32	300,472,181	3.83	23.63	141,777,129	1.79	29.72	364,446,290	4.52	2.20	526,411,250	6.52	7.86	771,030	.01	−36.98
54.70	−.36	1,958,758,040	18.87	121.95	486,721,845	4.63	57.11	281,734,458	2.71	94.60	775,395,891	7.28	107.27	942,598,044	9.08	79.06	5,108,871	.05	573.75
54.70	−6.57	1,828,564,581	18.86	−6.65	451,196,645	4.19	−6.48	263,411,545	2.72	−6.50	705,021,899	7.27	−6.67	880,314,546	9.14	−5.97	-----	-----	−100.00

$5,000-$10,000

30.38	-----	$495,354,234	32.60	-----	-----	-----	-----	-----	-----	-----	$165,868,818	10.91	-----	$161,238,275	10.61	-----	-----	-----	-----
33.87	19.53	530,770,260	27.20	7.15	$128,969,639	6.61	-----	$72,909,952	2.71	-----	126,391,211	6.48	−23.80	171,907,269	8.81	6.62	-----	-----	-----
33.54	28.53	650,038,458	25.67	22.47	237,535,657	9.38	84.18	69,021,107	2.73	30.45	179,298,821	7.08	41.86	220,602,275	8.71	28.33	-----	-----	-----
36.59	50.37	908,454,138	26.03	39.75	321,776,001	9.22	35.46	218,506,729	6.26	216.58	186,529,600	5.34	4.03	241,081,551	6.93	9.69	$13,498,714	0.39	-----
41.31	17.02	682,675,071	18.88	−21.85	315,390,492	8.72	−1.98	285,348,114	7.89	30.59	183,518,576	5.08	−1.60	252,477,275	6.98	4.34	16,190,435	.45	19.94
46.96	−10.19	402,162,409	14.06	−41.09	245,779,077	8.59	−22.07	102,813,373	3.59	−63.97	171,850,952	6.01	−6.37	236,284,018	8.26	−6.41	10,107,083	.35	−37.57
44.45	1.54	491,532,459	16.03	22.22	245,629,031	8.01	−.06	148,491,819	4.84	44.43	190,973,026	6.23	11.13	297,860,515	9.71	26.06	6,541,104	.21	−35.28
44.61	3.24	492,520,455	15.61	.20	259,884,355	8.24	5.80	143,515,254	4.55	−3.35	194,637,790	6.17	1.92	324,604,368	10.29	9.00	5,027,181	.16	−23.14
44.47	5.18	622,609,716	18.71	26.41	312,946,170	9.40	20.42	195,377,332	5.87	36.14	225,020,805	6.76	15.61	267,829,490	8.05	−17.51	-----	-----	−100.00

$10,000-$40,000

22.58	-----	$792,527,279	32.20	-----	-----	-----	-----	-----	-----	-----	$260,572,583	8.15	-----	$331,020,283	13.45	-----	-----	-----	-----
28.30	30.98	349,262,611	13.58	−55.93	$190,550,062	7.41	-----	$75,503,781	2.94	-----	130,477,855	5.07	−34.95	279,692,021	10.85	−15.69	-----	-----	-----
31.23	20.80	344,279,688	12.23	−1.43	309,461,756	10.99	62.40	77,917,909	2.77	3.07	139,992,395	4.97	7.28	283,889,066	10.08	1.72	-----	-----	-----
30.84	36.30	581,659,263	14.97	68.95	507,548,905	13.06	64.01	257,196,217	6.62	230.09	174,559,929	4.49	24.52	338,993,754	8.73	19.41	$22,696,282	0.58	-----
33.27	19.14	525,329,163	12.24	−9.68	523,019,533	12.19	3.05	264,762,587	6.17	2.94	181,388,491	4.22	4.07	358,312,915	8.35	5.70	27,298,634	.64	20.72
35.11	−17.92	318,664,790	9.55	−39.34	500,438,715	11.70	−23.35	114,396,741	3.43	−56.79	178,558,952	5.35	−1.56	328,516,754	9.84	−8.32	17,595,414	.53	−35.78
31.82	1.07	387,248,817	10.41	21.52	381,170,751	10.24	−2.37	244,242,030	6.56	113.50	199,275,425	5.35	11.60	448,476,175	12.05	36.52	13,357,150	.36	−24.09
32.04	14.66	444,809,909	10.49	14.86	424,929,481	10.03	11.48	261,665,592	6.17	7.13	216,873,318	5.12	8.83	495,749,907	11.79	10.54	13,616,295	.32	1.94
31.41	6.99	505,578,097	11.03	13.66	457,910,707	9.39	7.76	404,851,829	8.83	54.72	216,056,360	5.37	13.46	495,670,714	10.82	−.02	14,739,003	.32	8.39

$40,000-$100,000

12.75	-----	$393,261,273	32.12	-----	-----	-----	-----	-----	-----	-----	$70,039,033	5.72	-----	$176,405,864	14.41	-----	-----	-----	-----
19.67	55.68	99,920,833	8.08	−74.59	$106,877,615	8.65	-----	$36,633,783	2.96	-----	42,963,070	3.48	−38.66	140,472,512	11.37	−20.37	-----	-----	-----
22.17	3.58	83,868,894	7.39	−16.06	161,125,890	14.19	70.76	21,056,811	1.85	−42.52	36,763,656	3.24	−14.43	129,053,423	11.37	−8.13	-----	-----	-----
21.71	28.81	151,326,348	10.13	80.43	270,015,055	18.07	67.58	96,257,758	6.44	357.13	48,473,761	3.25	31.85	144,156,938	9.65	11.70	$9,631,093	0.64	-----
22.62	4.85	127,395,790	8.47	−15.81	249,257,852	16.58	−7.69	50,762,995	3.38	−47.26	54,881,549	3.65	13.22	140,714,645	9.37	−2.39	9,496,636	.63	−1.40
22.72	−27.11	66,156,857	6.06	−48.07	169,488,443	15.53	−32.00	28,416,397	2.61	−44.02	46,203,761	4.23	−15.81	110,016,990	10.08	−21.82	6,954,728	.64	−26.77
19.95	12.52	95,459,891	6.83	44.29	168,141,580	12.03	−.79	125,758,037	9.00	342.55	55,294,638	3.96	19.68	176,720,713	12.65	60.63	6,191,216	.44	−10.98
19.92	4.72	96,655,653	6.59	1.25	159,003,024	10.84	−5.44	124,358,911	8.48	−1.11	57,833,137	3.94	4.59	170,955,019	11.66	−3.26	7,059,485	.48	14.02
20.06	20.12	105,546,452	6.03	9.20	178,998,915	10.23	12.58	205,423,615	11.74	65.19	63,118,609	3.61	9.14	202,470,631	11.58	18.43	8,203,919	.47	16.21

$100,000-$300,000

8.98	-----	$340,178,477	32.83	-----	-----	-----	-----	-----	-----	-----	$40,592,233	3.92	-----	$158,870,428	15.34	-----	-----	-----	-----
12.99	28.55	52,827,665	5.74	−84.47	$95,389,445	10.37	-----	$29,521,356	3.21	-----	24,591,452	2.67	−39.42	119,539,786	12.99	−24.76	-----	-----	-----
13.89	−19.25	47,556,022	6.84	−9.98	127,205,976	18.30	33.35	11,391,254	1.64	−61.41	16,703,675	2.40	−32.08	91,030,392	13.10	−23.85	-----	-----	-----
13.45	24.30	73,660,080	8.26	54.89	220,115,680	24.68	73.04	50,178,505	5.63	340.50	23,021,880	2.58	37.83	91,467,182	10.26	.48	$2,709,043	0.97	-----
13.48	−28.63	45,124,685	7.11	−38.74	127,322,901	20.05	−42.16	14,175,933	2.23	−71.75	23,019,724	3.63	−.01	62,111,809	9.78	−32.09	4,777,368	.75	−45.14
14.26	−30.90	20,691,526	4.99	−54.15	71,746,058	17.30	−43.65	6,402,364	1.54	−54.84	15,671,321	3.78	−31.92	39,619,237	9.56	−36.21	3,751,427	.90	−21.48
11.79	30.00	26,420,307	4.05	27.69	87,974,365	13.49	22.62	94,473,502	14.49	1,375.60	23,392,504	3.59	49.27	80,181,186	12.30	102.38	2,521,390	.39	−32.79
12.37	7.78	23,512,757	3.51	−11.00	67,827,375	10.13	−22.90	98,103,097	14.65	3.84	22,498,817	3.36	−3.82	73,159,120	10.92	−8.76	2,699,355	.40	7.03
13.03	36.02	26,294,699	3.04	11.83	89,815,387	10.38	32.42	157,471,807	18.20	60.52	27,272,001	3.15	21.22	85,239,017	9.85	16.51	3,901,725	.45	44.54

$300,000 AND OVER

3.52	-----	$365,584,201	31.71	-----	-----	-----	-----	-----	-----	-----	$39,668,853	3.44	-----	$165,733,900	14.38	-----	-----	-----	-----
5.52	7.00	29,990,674	3.80	−91.80	$59,921,390	7.59	-----	$23,270,128	2.95	-----	16,444,131	2.08	−58.55	111,468,127	14.12	−32.74	-----	-----	-----
3.45	−38.18	22,553,643	4.57	−24.80	78,521,014	15.90	31.04	8,018,771	1.62	−65.54	13,725,294	2.78	−16.53	74,610,507	15.11	−33.07	-----	-----	-----
5.15	4.56	28,700,094	5.25	27.25	106,616,418	19.49	35.78	55,144,479	10.08	587.69	13,375,729	2.45	−2.55	60,087,093	10.98	−19.47	$8,035,624	1.47	-----
5.90	−30.59	17,540,518	5.30	−38.86	46,908,557	14.17	−56.00	8,943,560	2.70	−83.78	9,039,869	2.73	−32.42	34,276,922	10.36	−42.96	2,568,830	.78	−68.03
4.84	−47.63	8,364,453	3.96	−52.33	26,118,654	12.37	−44.32	2,425,171	1.15	−72.88	8,617,419	4.09	−4.34	18,259,521	8.65	−46.73	1,872,593	.89	−27.10
4.13	77.64	9,087,137	2.06	8.64	33,719,341	7.65	29.10	125,639,900	28.53	5,080.66	11,277,082	2.56	30.41	38,158,657	8.66	108.98	2,071,476	.47	10.62
5.20	30.91	10,574,992	2.31	16.37	16,548,158	3.62	−50.92	139,630,878	30.53	11.14	8,568,433	1.87	−24.02	40,490,631	8.85	6.11	1,985,993	.43	−4.13
5.88	42.02	5,209,281	.91	−50.74	33,051,006	5.75	99.73	163,551,811	28.44	17.13	12,530,449	2.18	46.24	46,307,421	8.05	14.37	2,254,037	.39	13.50

GRAND TOTAL

22.11	-----	$2,642,263,385	31.64	-----	-----	-----	-----	-----	-----	-----	$643,802,657	7.71	-----	$1,080,879,405	12.94	-----	-----	-----	-----
30.21	97.59	2,865,412,746	23.72	8.45	$775,086,665	6.42	-----	$318,170,617	2.63	-----	684,343,399	5.67	6.30	936,715,456	7.76	−13.34	-----	-----	-----
46.59	126.69	3,124,355,196	17.61	9.04	1,214,914,422	6.85	56.75	291,185,704	1.64	−8.48	975,679,666	5.50	42.57	1,403,485,691	7.91	49.83	-----	-----	-----
47.94	30.10	3,877,550,454	17.28	24.11	1,831,430,243	8.16	50.75	999,364,287	4.45	243.20	1,019,094,265	4.54	4.45	1,437,401,878	6.41	2.42	$33,377,222	0.28	-----
57.21	41.97	3,205,555,387	12.01	−17.33	1,701,229,432	6.37	−7.11	1,020,542,719	3.82	2.12	1,047,423,738	3.92	2.78	1,647,749,856	6.17	14.63	61,549,572	.23	−2.88
59.21	−9.54	2,366,318,610	10.14	−26.18	1,341,186,308	5.75	−21.16	462,858,673	1.98	54.65	1,177,957,882	5.05	12.46	1,643,344,480	7.04	−.27	46,994,406	.20	−23.65
55.06	−.86	2,839,771,144	11.42	20.01	1,427,127,347	5.74	6.41	991,351,580	3.99	114.18	1,224,928,908	4.92	3.99	1,996,528,770	8.03	21.49	33,988,634	.14	−27.68
48.54	3.02	4,733,033,407	10.14	66.67	1,681,983,948	5.74	17.86	1,172,154,628	4.00	18.24	1,816,280,109	6.19	48.28	2,514,822,308	8.58	25.96	43,941,095	.15	29.28
47.12	−3.26	4,689,233,941	16.05	−.93	1,778,556,412	6.09	5.74	1,506,576,239	5.16	28.53	1,804,658,881	6.18	−.64	2,433,301,637	8.33	−3.24	29,118,684	.10	−33.73

[1] Including capital net gains.

[2] Returns filed up to Sept. 30, 1925.

Summary of income 1916 to 1924, inclusive—Continued

NONTAXABLE

Year	Dividends: Amount	Dividends: Per cent of total income	Dividends: Per cent of increase or decrease	Total income from service and business: Amount	Per cent of total income	Per cent of increase or decrease	Total income from investments: Amount	Per cent of total income	Per cent of increase or decrease	Total income: Amount	Per cent of increase or decrease	General deductions: Amount	Per cent of total income	Per cent of increase or decrease	Contributior: Amount	Per cent total income
1918	$147,695,999	6.71		$1,840,334,686	83.66		$359,559,836	16.34		$2,199,894,522		$168,031,157	7.64			
1919	139,702,665	6.31	1.36	2,000,774,562	84.57	9.04	366,204,000	15.43	1.85	2,372,979,162	7.87	205,107,374	8.64	22.06		
1920	187,019,860	4.93	24.93	3,303,381,105	87.00	64.61	493,529,413	13.00	34.77	3,796,910,518	60.01	290,240,710	7.64	41.51		
1921	426,920,752	5.57	128.28	6,406,163,756	83.61	93.93	1,255,450,210	16.39	154.38	7,661,613,966	101.70	1,494,086,008	19.50	414.77		
1922	381,045,011	5.06	−10.75	6,330,544,552	84.15	−1.18	1,192,569,995	15.85	−5.01	7,523,114,547	−1.81	1,147,990,914	15.26	−23.16	$52,425,542	1.[illegible]
1923	431,134,891	4.82	13.15	7,485,137,169	83.61	18.24	1,467,166,748	16.39	23.03	8,952,303,917	19.00	1,494,902,150	16.70	30.22	114,647,822	1.[illegible]
1924[1]	431,068,666	5.16	.68	7,007,703,756	83.26	−6.38	1,409,177,242	16.74	−3.95	8,416,880,998	−5.98	1,408,015,025	16.73	−5.81	108,618,901	1.[illegible]
LESS THAN $5,000																
1916	$38,040,710	3.98		$703,516,995	73.57		$252,712,502	26.43		$956,229,497		$331,560,482	34.67			
1917	200,687,577	4.35	427.56	3,949,908,521	85.71	461.45	658,398,998	14.29	160.53	4,608,307,519	381.92	427,465,590	9.28	28.93		
1918	187,843,888	2.39	−6.40	6,704,137,579	85.15	69.73	1,169,485,902	14.85	77.63	7,873,623,481	70.86	511,088,429	6.49	19.56		
1919	175,781,309	1.80	−6.42	8,662,101,440	88.78	29.21	1,094,194,566	11.22	−6.44	9,756,296,006	23.91	774,504,248	7.94	51.54		
1920	184,945,655	1.48	5.21	11,242,842,277	89.81	29.79	1,274,955,590	10.19	16.52	12,517,797,867	28.30	750,250,450	5.99	−3.13		
1921	134,893,737	1.74	−27.06	6,771,782,166	87.35	−39.77	980,750,886	12.65	−23.08	7,752,533,052	−38.07	704,626,790	9.09	−6.08		
1922	144,150,214	1.79	6.86	7,035,362,205	87.17	3.89	1,035,779,384	12.83	5.61	8,071,141,589	4.11	656,182,794	8.13	−6.87	$132,158,345	1.[illegible]
1923	271,894,606	2.62	88.62	8,404,780,343	80.97	19.46	1,975,087,412	19.03	90.69	10,379,867,755	28.60	1,052,810,916	10.14	60.44	182,006,769	1.7
1924[1]	255,149,836	2.63	−6.16	7,851,491,971	80.96	−6.58	1,846,486,281	19.04	−6.51	9,697,978,252	−6.57	985,118,512	10.16	−6.43	169,637,316	1.7
$5,000–$10,000																
1916	$144,285,827	9.70		$1,048,270,762	68.98		$471,393,920	31.02		$1,519,664,682		$482,416,705	31.74			
1917	279,534,045	14.32	93.74	1,373,534,184	70.39	31.03	577,832,725	29.61	22.58	1,951,366,709	28.41	123,858,621	6.35	−74.33		
1918	326,431,180	12.89	16.78	1,806,057,694	71.32	31.49	726,532,276	28.68	25.70	2,532,589,970	29.78	386,699,954	15.27	212.21		
1919	322,225,337	9.23	−1.29	2,726,065,040	78.10	50.94	764,235,202	21.90	7.22	3,490,300,242	37.83	536,162,989	15.36	38.65		
1920	284,901,851	[illegible]	[illegible]	2,778,125,619	76.84	1.91	837,118,137	23.16	9.54	3,615,243,756	3.58	546,912,793	15.13	2.01		
1921	349,231,315	12.21	−9.27	2,693,181,885	73.17	−21.66	767,473,398	26.83	−8.32	2,860,678,255	−20.87	481,899,016	16.85	−11.89		
1922	321,841,542	10.50	−7.84	2,248,705,482	73.34	7.43	817,216,187	26.65	6.48	3,065,921,669	7.18	403,019,992	13.15	−16.37	$64,364,934	2.1
1923	326,888,555	10.36	1.57	2,303,186,669	73.01	2.42	851,217,894	26.99	4.16	3,154,404,763	2.89	392,620,141	12.45	−2.58	65,379,816	2.[illegible]
1924[1]	224,371,886	6.74	−31.36	2,611,031,839	78.45	13.37	717,222,181	21.55	−15.74	3,328,254,020	5.51	364,367,738	10.95	−7.20	57,743,490	1.7
$10,000–$40,000																
1916	$581,143,283	23.62		$1,348,147,064	54.78		$1,112,736,149	45.22		$2,460,883,213		$654,683,030	26.60			
1917	819,225,805	31.85	40.97	1,343,178,866	52.23	−0.37	1,228,795,681	47.77	10.43	2,571,974,547	4.51	157,788,859	6.13	−75.90		
1918	780,753,121	27.73	−4.70	1,610,816,203	57.21	19.93	1,204,624,582	42.78	−1.97	2,815,440,785	9.47	389,131,461	13.82	146.62		
1919	804,590,114	20.71	3.05	2,544,660,865	65.49	57.97	1,340,580,079	34.50	11.28	3,885,240,944	38.00	565,753,063	14.56	45.39		
1920	983,757,683	22.91	22.20	2,740,744,329	63.87	7.70	1,550,357,123	36.13	15.65	4,291,081,452	10.45	803,576,465	18.73	42.04		
1921	817,122,004	24.49	−16.89	1,995,366,048	59.79	−27.20	1,341,793,124	40.21	−13.45	3,337,159,172	−22.23	668,636,056	20.04	−16.79		
1922	863,648,463	23.21	5.69	2,197,026,105	59.03	10.11	1,524,757,213	40.97	13.64	3,721,783,318	11.53	539,663,348	14.50	−19.29	$73,267,830	1.[illegible]
1923	1,023,069,645	24.14	18.45	2,489,369,726	58.73	13.31	1,749,249,165	41.27	14.72	4,238,618,891	13.89	617,765,177	14.57	14.47	89,245,072	2.[illegible]
1924[1]	1,018,416,938	22.22	−.45	2,807,610,562	61.27	12.78	1,774,903,015	38.73	1.47	4,582,513,577	8.11	543,645,355	11.86	−12.00	89,414,614	1.[illegible]
$40,000–$100,000																
1916	$428,395,085	34.99		$549,403,254	44.87		$674,839,982	55.12		$1,224,243,236		$249,970,501	20.42			
1917	566,036,908	45.79	32.13	486,521,981	39.36	−11.44	749,472,490	60.64	11.06	1,235,994,471	0.96	73,800,122	5.97	−70.48		
1918	451,873,000	39.79	−20.17	517,538,461	45.60	6.44	617,690,079	54.40	−17.58	1,135,528,540	−8.13	167,526,367	14.75	127.00		
1919	449,900,433	30.11	−.44	841,931,392	56.35	62.59	652,162,225	43.65	5.58	1,494,093,617	31.58	227,443,897	15.22	35.77		
1920	530,646,616	35.30	17.95	767,473,591	51.05	−8.84	735,739,446	48.95	12.82	1,503,213,037	.61	324,641,792	21.60	42.73		
1921	415,898,953	38.12	−21.62	511,925,945	46.92	−33.30	579,074,432	53.08	−21.29	1,091,000,377	−27.42	239,507,764	21.95	−26.22		
1922	491,092,340	35.14	18.08	668,247,259	47.81	30.54	729,298,907	52.18	25.94	1,397,546,166	28.10	202,486,385	14.49	−15.46	$34,602,355	2.[illegible]
1923	558,539,947	38.09	13.73	672,071,342	45.83	.57	794,387,588	54.17	8.92	1,466,158,930	4.93	214,399,373	14.62	5.88	49,727,905	2.[illegible]
1924[1]	634,458,757	36.27	13.59	840,792,572	48.07	25.10	908,251,916	51.93	14.33	1,749,044,488	19.27	202,430,321	11.57	−5.58	45,781,354	2.[illegible]
$100,000–$300,000																
1916	$463,390,882	58.94		$433,142,931	41.80		$602,853,543	58.19		$1,035,996,473		$172,781,750	16.68			
1917	478,706,399	52.03	18.67	297,246,225	32.31	−31.37	622,837,637	67.69	3.31	920,083,862	−11.19	44,939,862	4.88	−73.99		
1918	304,651,104	43.83	−36.36	282,655,909	40.67	−4.91	412,385,171	59.33	−33.79	695,041,080	−24.46	105,909,523	15.24	135.67		
1919	304,712,800	34.17	.02	463,902,671	52.02	64.12	427,910,905	47.98	3.76	891,813,578	28.31	162,272,117	18.20	53.22		
1920	272,888,443	42.97	−10.44	272,202,090	42.87	−41.32	362,797,344	57.13	−15.22	634,999,434	−28.79	154,349,256	24.31	−4.88		
1921	197,647,524	47.66	−27.57	157,972,052	38.10	−41.97	256,689,509	61.90	−29.25	414,661,561	−34.70	105,192,515	25.37	−31.85		
1922	260,172,120	39.90	31.63	285,738,791	43.82	80.88	366,267,200	56.18	42.69	652,005,991	57.24	102,207,076	15.68	−2.84	$22,780,981	3.[illegible]
1923	299,215,378	44.67	15.01	272,292,231	40.65	−4.71	397,572,670	59.35	8.55	669,864,901	2.74	104,448,204	15.59	2.19	24,176,472	3.[illegible]
1924[1]	362,374,247	41.89	21.11	386,275,041	44.65	41.86	478,786,990	55.35	20.43	865,062,031	29.14	97,006,510	11.21	−7.12	28,430,012	3.[illegible]

Summary of income 1916 to 1924, inclusive—Continued

	Total income from service and business			Total income from investments			Total income		General deductions			Contributions			Net income		
nt of ase ease	Amount	Per cent of total income	Per cent of increase or decrease	Amount	Per cent of total income	Per cent of increase or decrease	Amount	Per cent of increase or decrease	Amount	Per cent of total income	Per cent of increase or decrease	Amount	Per cent of total income	Per cent of increase or decrease	Amount	Per cent of total income	Per cent of increase or decrease
							NONTAXABLE										
......	$1,840,334,686	83.66	......	$359,559,836	16.34	......	$2,199,894,522	......	$168,031,157	7.64	......	......	......	......	$2,031,863,365	92.36	......
1.36	2,006,774,562	84.57	9.04	366,204,600	15.43	1.85	2,372,979,162	7.87	205,107,374	8.64	22.06	......	......	......	2,167,871,788	91.36	6.69
24.93	3,303,381,105	87.00	64.61	493,529,413	13.00	34.77	3,796,910,518	60.01	290,240,710	7.64	41.51	......	......	......	3,506,669,808	92.36	61.76
28.28	6,406,163,756	83.61	93.93	1,255,450,210	16.39	154.38	7,661,613,966	101.79	1,494,086,008	19.50	414.77	......	......	......	6,167,527,958	80.50	75.88
0.75	6,330,544,552	84.15	−1.18	1,192,569,995	15.85	−5.01	7,523,114,547	−1.81	1,147,390,914	15.26	−23.16	$82,425,542	1.10	......	6,292,698,091	83.64	2.03
13.15	7,485,137,169	83.61	18.24	1,467,166,748	16.39	23.03	8,952,303,917	19.00	1,494,902,150	16.70	30.22	114,647,822	1.28	......	7,342,753,945	82.02	16.69
.63	7,007,703,756	83.26	−6.38	1,409,177,242	16.74	−3.95	8,416,880,998	−5.98	1,408,015,025	16.73	−5.81	108,618,901	1.29	−5.26	6,900,247,072	81.98	−6.03
							LESS THAN $5,000										
......	$703,516,995	73.57	......	$252,712,502	26.43	......	$956,229,497	......	$331,560,482	34.67	......	......	......	......	$624,669,015	65.33	......
27.56	3,949,908,521	85.71	461.45	658,398,998	14.29	160.53	4,608,307,519	381.92	427,465,590	9.28	28.93	......	......	......	4,180,841,929	90.72	569.29
−6.40	6,704,137,579	85.15	69.73	1,169,485,902	14.85	77.63	7,873,623,481	70.86	511,088,429	6.49	19.56	......	......	......	7,362,535,052	93.51	76.10
−6.42	8,662,101,440	88.78	29.21	1,094,194,566	11.22	−6.44	9,756,296,006	23.91	774,504,248	7.94	51.54	......	......	......	8,981,791,758	92.06	21.99
5.21	11,242,842,277	89.81	29.79	1,274,955,590	10.19	16.52	12,517,797,867	28.83	750,250,450	5.99	−3.13	......	......	......	11,767,547,417	94.01	31.02
−27.06	6,771,782,166	87.35	−39.77	980,750,886	12.65	−23.08	7,752,533,052	−38.07	704,626,799	9.09	−6.08	......	......	......	7,047,906,253	90.91	−40.11
6.86	7,035,362,205	87.17	3.89	1,035,779,384	12.83	5.61	8,071,141,589	4.11	656,182,794	8.13	−6.87	$132,158,345	1.64	......	7,282,800,450	90.23	3.33
88.62	8,404,780,343	80.97	19.46	1,975,087,412	19.03	90.69	10,379,867,755	28.60	1,052,810,916	10.14	60.44	182,006,769	1.75	......	9,145,050,070	88.10	25.57
−6.16	7,851,491,971	80.96	−6.58	1,846,486,281	19.04	−6.51	9,697,978,252	−6.57	985,118,512	10.16	−6.43	169,637,316	1.75	−6.80	8,543,222,394	88.09	−6.58
							$5,000–$10,000										
......	$1,048,270,762	68.98	......	$471,393,920	31.62	......	$1,519,664,682	......	$482,416,705	31.74	......	......	......	......	$1,037,247,977	69.26	......
93.74	1,373,534,184	70.39	31.03	577,882,525	29.61	22.58	1,951,366,709	28.41	123,858,621	6.35	−74.33	......	......	......	1,827,508,088	93.65	76.19
16.78	1,806,057,694	71.32	31.49	726,332,276	28.68	25.70	2,532,389,970	29.78	386,699,954	15.27	212.21	......	......	......	2,145,690,016	84.73	17.41
−1.29	2,726,065,040	78.10	50.94	764,235,202	21.90	5.22	3,490,300,242	37.83	536,162,989	15.36	38.65	......	......	......	2,954,137,253	84.64	37.68
19.45	2,778,125,619	76.84	1.91	837,118,137	23.16	9.54	3,615,243,756	3.58	546,912,793	15.13	2.01	......	......	......	3,068,330,963	84.87	3.87
−9.27	2,093,184,885	73.17	−24.66	767,473,368	26.83	−8.32	2,860,658,253	−20.87	481,859,016	16.85	−11.89	......	......	......	2,378,799,237	83.15	−22.47
−7.84	2,248,705,482	73.34	7.43	817,216,187	26.65	6.48	3,065,921,669	7.18	403,019,992	13.15	−16.37	$64,364,934	2.10	......	2,598,536,743	84.76	9.24
1.57	2,303,186,669	73.01	2.42	851,217,894	26.99	4.16	3,154,404,563	2.89	392,620,141	12.45	−2.58	65,379,816	2.07	1.57	2,696,404,546	85.48	3.76
−31.36	2,611,031,839	78.45	13.37	717,222,181	21.55	−15.74	3,328,254,020	5.51	364,367,738	10.95	−7.20	57,743,490	1.73	−11.68	2,906,142,792	87.32	7.78
							$10,000–$40,000										
......	$1,348,147,064	54.78	......	$1,112,736,149	45.22	......	$2,460,883,213	......	$654,683,030	26.60	......	......	......	......	$1,806,200,183	73.40	......
40.97	1,343,178,866	52.23	−0.37	1,228,795,681	47.77	10.43	2,571,974,547	4.51	157,788,879	6.13	−75.90	......	......	......	2,414,185,668	93.87	33.66
−4.70	1,610,816,203	57.21	19.93	1,204,624,582	42.78	−1.97	2,815,440,785	9.47	389,131,461	13.82	146.62	......	......	......	2,426,309,324	86.18	.50
3.05	2,544,660,865	65.49	57.97	1,340,580,679	34.50	11.28	3,885,240,944	38.00	565,753,063	14.56	45.39	......	......	......	3,319,487,881	85.44	36.81
22.20	2,740,744,329	63.87	7.70	1,550,357,123	36.13	15.65	4,291,081,452	10.45	803,576,455	18.73	42.04	......	......	......	3,487,504,987	81.27	5.06
−16.89	1,995,366,048	59.79	−27.20	1,341,793,124	40.21	−13.45	3,337,159,172	−22.23	668,636,056	20.04	−16.79	......	......	......	2,668,523,116	79.96	−23.48
5.69	2,197,026,105	59.03	10.11	1,524,757,213	40.97	13.64	3,721,783,318	11.53	539,663,348	14.50	−19.29	$73,207,830	1.97	......	3,108,912,140	83.53	16.50
18.45	2,489,369,726	58.73	13.31	1,749,249,165	41.27	14.72	4,238,618,891	13.89	617,765,177	14.57	14.47	89,245,072	2.11	21.91	3,531,608,642	83.32	13.60
−.45	2,807,610,562	61.27	12.78	1,774,903,015	38.73	1.47	4,582,513,577	8.11	543,645,355	11.86	−12.00	89,414,614	1.95	.19	3,949,453,548	86.19	11.83
							$40,000–$100,000										
......	$549,403,254	44.87	......	$674,839,982	55.12	......	$1,224,243,236	......	$249,970,501	20.42	......	......	......	......	$974,272,735	79.58	......
32.13	486,521,981	39.36	−11.44	749,472,490	60.64	11.06	1,235,994,471	0.96	73,800,122	5.97	−70.48	......	......	......	1,162,194,349	94.03	19.29
−20.17	517,838,461	45.60	6.44	617,690,079	54.40	−17.58	1,135,528,540	−8.13	167,526,367	14.75	127.00	......	......	......	968,002,173	85.25	−16.71
−.44	841,931,392	56.35	62.59	652,162,225	43.65	5.58	1,494,093,617	31.58	227,443,897	15.22	35.77	......	......	......	1,266,649,720	84.78	30.85
17.95	767,473,591	51.05	−8.84	735,739,446	48.95	12.82	1,503,213,037	.61	324,641,792	21.60	42.73	......	......	......	1,178,571,245	78.40	−6.95
−21.62	511,925,945	46.92	−33.30	579,074,432	53.08	−21.29	1,091,000,377	−27.42	239,507,764	21.95	−26.22	......	......	......	851,492,613	78.05	−27.75
18.08	668,247,259	47.81	30.54	729,298,907	52.18	25.94	1,397,546,166	28.10	202,486,385	14.49	−15.46	$34,602,355	2.48	......	1,160,457,426	83.04	36.29
13.73	672,071,342	45.83	.57	794,387,588	54.17	8.92	1,466,458,930	4.93	214,399,373	14.62	5.88	40,727,905	2.78	17.70	1,211,331,652	82.60	4.38
13.59	840,792,572	48.07	25.10	908,251,916	51.93	14.33	1,749,044,488	19.27	202,430,321	11.57	−5.58	45,781,354	2.62	12.41	1,500,832,813	85.81	23.90
							$100,000–$300,000										
......	$433,142,931	41.80	......	$602,853,543	58.19	......	$1,035,996,474	......	$172,781,750	16.68	......	......	......	......	$863,214,724	83.32	......
18.67	297,246,225	32.31	−31.37	622,837,637	67.69	3.31	920,083,862	−11.19	44,939,862	4.88	−73.99	......	......	......	875,144,000	95.12	1.38
−36.36	282,655,909	40.67	−4.91	412,385,171	59.33	−33.79	695,041,080	−24.46	105,809,523	15.24	135.67	......	......	......	589,131,557	84.76	−32.68
.02	463,902,671	52.02	64.12	427,910,905	47.98	3.76	891,813,576	28.31	162,272,117	18.20	53.22	......	......	......	729,541,459	81.80	23.83
−10.44	272,202,090	42.87	−41.32	362,797,344	57.13	−15.22	634,999,434	−28.79	151,319,256	24.31	−4.88	......	......	......	480,650,178	75.69	−34.12
−27.57	157,972,052	38.10	−41.97	256,689,509	61.90	−29.25	414,661,561	−34.70	105,192,515	25.37	−31.85	......	......	......	309,469,046	74.63	−35.61
31.63	285,738,791	43.82	80.88	366,267,200	56.18	42.69	652,005,991	57.24	102,207,076	15.68	−2.84	$22,780,981	3.49	......	527,017,934	80.83	70.30
15.01	272,292,231	40.65	−4.71	397,572,670	59.35	8.55	669,864,901	2.74	104,448,204	15.59	2.19	24,176,472	3.61	6.13	541,240,225	80.80	2.70
21.11	386,275,041	44.65	41.86	478,786,990	55.35	20.43	865,062,631	29.14	97,006,510	11.21	−7.12	28,430,012	3.29	17.59	739,625,509	85.50	36.65

[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	11.23	-6.44	9,756,296,006	23.91	774,504,248	7.94	51.84		
1920	184,945,655	1.48	5.21	11,242,842,277	89.81	29.79	1,274,955,590	10.19	10.62	12,517,797,867	2.83	750,250,450	5.09	-3.13		
1921	134,893,737	1.74	-27.06	6,771,782,166	87.35	-39.77	980,750,886	12.65	-23.06	7,752,533,032	-38.07	704,626,799	9.09	-6.04		
1922	144,150,214	1.79	6.86	7,035,362,205	87.17	3.89	1,035,779,384	12.83	5.61	8,071,141,589	4.11	656,182,794	8.13	-0.87	$132,158,345	
1923	271,894,606	2.62	88.62	8,404,780,343	80.97	19.46	1,975,087,412	19.03	90.69	10,379,867,755	28.60	1,052,810,916	10.14	60.44	182,000,769	
1924 [1]	255,149,836	2.63	-6.16	7,851,491,971	80.96	-6.58	1,846,486,281	19.04	-6.51	9,697,978,252	-6.57	985,118,512	10.16	-6.43	169,637,316	
								$5,000-$10,000								
1916	$144,285,827	9.70	----	$1,048,270,762	68.98	----	$471,5?5,930	31.02	----	$1,519,6?1,682	----	$482,416,705	31.74	----	----	
1917	279,534,015	14.32	93.74	1,373,534,184	70.39	31.03	577,852,525	29.61	22.78	1,951,386,709	28.41	123,858,621	6.35	-74.33	----	
1918	326,431,180	12.89	16.78	1,806,057,694	71.32	31.49	726,532,276	28.68	25.70	2,532,589,970	29.78	386,699,951	15.27	212.21	----	
1919	322,225,3?7	9.23	-1.29	2,726,065,040	78.10	50.94	764,235,202	21.90	5.22	3,490,300,242	37.83	536,162,989	15.36	38.65	----	
1920	384,901,851	10.05	19.45	2,778,125,619	76.84	1.91	837,118,137	23.16	9.54	3,615,243,756	3.55	546,912,793	15.13	2.01	----	
1921	349,231,315	12.21	-9.27	2,093,181,885	73.17	-24.66	767,474,368	26.83	-8.32	2,860,658,253	-20.87	481,899,016	16.85	-11.89	----	
1922	321,841,542	10.50	-7.84	2,248,705,482	73.34	7.43	817,216,187	26.66	6.48	3,065,921,669	7.18	403,019,992	13.15	-16.37	$64,364,934	2
1923	326,988,553	10.36	1.57	2,303,196,609	73.01	2.42	851,217,894	26.99	4.16	3,154,404,703	2.89	392,620,141	12.45	-2.58	65,379,816	2
1924 [1]	224,371,886	6.74	-31.36	2,611,031,839	78.45	13.37	717,222,181	21.55	-15.71	3,328,254,020	5.51	364,367,738	10.95	-7.20	57,713,490	1
								$10,000-$40,000								
1916	$581,113,283	23.62	----	$1,348,147,064	54.78	----	$1,112,736,149	45.22	----	$2,460,883,213	----	$651,683,030	26.40	----	----	
1917	819,225,805	31.85	40.97	1,343,178,866	52.23	-0.37	1,228,796,681	47.77	10.43	2,571,974,547	4.51	157,788,859	6.13	-75.90	----	
1918	780,753,121	27.73	-4.70	1,610,816,203	57.21	19.93	1,204,624,582	42.79	-1.97	2,815,440,785	9.47	389,131,461	13.82	146.62	----	
1919	804,560,114	20.71	3.05	2,544,660,865	65.49	57.97	1,340,580,079	34.50	11.28	3,885,240,944	38.00	565,753,063	14.56	45.39	----	
1920	983,237,083	22.91	22.20	2,740,744,329	63.87	7.70	1,550,357,123	36.13	15.65	4,291,081,452	10.45	803,576,465	18.73	42.04	----	
1921	817,122,004	24.49	-16.89	1,995,366,048	59.79	-27.20	1,341,793,124	40.21	-13.45	3,337,159,172	-22.23	668,636,056	20.04	-16.79	----	
1922	863,648,453	23.21	5.69	2,197,026,105	59.03	10.11	1,524,757,213	40.97	13.64	3,721,783,318	11.53	539,663,318	14.50	-19.29	$73,267,830	1.
1923	1,023,009,645	24.14	18.45	2,489,369,726	58.73	13.31	1,749,249,165	41.27	14.72	4,238,618,891	13.89	617,765,177	14.57	14.47	89,215,072	2.
1924 [1]	1,018,416,938	22.22	-.45	2,807,610,562	61.27	12.78	1,774,903,615	38.73	1.47	4,582,513,517	8.11	543,645,355	11.86	-12.00	89,411,614	1.
								$40,000-$100,000								
1916	$428,395,685	34.99	----	$549,403,254	44.87	----	$674,839,982	55.12	----	$1,224,243,236	----	$249,970,501	20.42	----	----	
1917	566,036,908	45.79	32.13	486,521,981	39.36	-11.44	749,472,490	60.64	11.06	1,235,994,471	0.96	73,800,122	5.97	-70.48	----	
1918	451,873,000	39.79	-20.17	517,538,461	45.60	6.44	617,690,079	54.40	-17.58	1,135,528,540	-8.13	167,526,367	14.75	127.00	----	
1919	449,900,433	30.11	-.44	841,931,392	56.35	62.59	652,162,225	43.65	5.58	1,494,093,617	31.58	227,443,897	15.22	35.77	----	
1920	530,646,616	35.30	17.95	767,473,591	51.05	-8.84	735,739,446	48.95	12.82	1,503,213,037	.61	324,641,792	21.60	42.73	----	
1921	415,898,953	38.12	-21.62	511,925,945	46.92	-33.30	579,074,432	53.08	-21.29	1,091,000,377	-27.42	239,507,764	21.95	-26.22	----	
1922	491,092,340	35.14	18.08	668,247,259	47.81	30.54	729,298,907	52.18	25.94	1,397,546,166	28.10	202,486,385	14.49	-15.46	$34,602,355	2.
1923	558,539,947	38.09	13.73	672,071,342	45.83	.57	794,387,588	54.17	8.92	1,466,458,930	4.93	214,399,373	14.62	5.88	40,727,905	2.
1924 [1]	634,458,757	36.27	13.59	840,792,572	48.07	25.10	908,251,916	51.93	14.33	1,749,044,488	19.27	202,430,321	11.57	-5.58	45,781,354	2.
								$100,000-$300,000								
1916	$403,390,882	38.04	----	$433,142,931	41.80	----	$602,853,543	58.19	----	$1,035,996,474	----	$172,781,750	16.68	----	----	
1917	478,706,399	52.03	18.67	297,246,225	32.31	-31.37	622,837,637	67.69	3.31	920,083,862	-11.19	44,939,862	4.88	-73.99	----	
1918	304,651,104	43.83	-36.36	282,655,909	40.67	-4.91	412,385,171	59.33	-33.79	695,041,080	-24.46	105,909,523	15.24	135.67	----	
1919	304,712,800	34.17	.02	463,902,671	52.02	64.12	427,910,905	47.98	3.76	891,813,576	28.31	162,272,117	18.20	53.22	----	
1920	272,888,443	42.97	-10.44	272,202,090	42.87	-41.32	362,797,344	57.13	-15.22	634,999,434	-28.79	154,349,259	24.31	-4.88	----	
1921	197,647,524	47.66	-27.57	157,972,052	38.10	-41.97	256,680,509	61.90	-29.25	414,651,561	-34.70	105,192,515	25.37	-31.85	----	
1922	260,172,126	39.90	31.63	285,738,791	43.82	80.88	366,267,200	56.18	42.69	652,005,991	57.24	102,207,076	15.68	-2.84	$22,780,981	3.
1923	299,215,378	44.67	15.01	272,292,231	40.65	-4.71	397,572,670	59.35	8.55	669,864,901	2.74	104,448,204	15.59	2.19	24,176,472	3.
1924 [1]	362,374,217	41.89	21.11	386,275,041	44.65	41.86	478,786,990	55.35	20.43	865,062,031	29.14	97,006,510	11.21	-7.12	28,430,012	3.
								$300,000 AND OVER								
1916	$541,211,838	46.94	----	$406,270,290	35.24	----	$746,614,591	64.76	----	$1,152,884,881	----	$159,911,895	13.87	----	----	
1917	504,651,765	63.94	-6.75	156,718,153	19.86	-61.43	632,564,023	80.14	-15.28	789,282,176	-31.54	57,910,023	7.34	-63.79	----	
1918	269,500,954	54.57	-46.60	136,006,340	27.54	-13.21	357,836,755	72.46	-43.43	493,843,095	-37.43	92,735,227	18.78	60.14	----	
1919	246,862,167	45.13	-8.40	218,601,665	39.07	60.73	328,360,613	60.03	-8.24	546,962,278	10.76	106,950,689	19.55	15.33	----	
1920	192,206,287	58.06	-22.14	92,931,881	28.07	-57.49	238,091,908	71.93	-27.49	331,023,789	-39.48	84,669,204	25.58	-20.83	----	
1921	135,238,114	64.05	-29.64	47,137,904	22.32	-49.28	164,017,647	77.68	-31.11	211,155,551	-36.21	57,621,216	27.29	-31.95	----	
1922	202,269,391	45.93	49.56	186,618,468	42.38	295.90	253,776,606	57.62	54.73	440,395,074	108.56	58,927,146	13.38	2.27	$15,738,182	3.
1923	215,820,460	47.18	6.70	190,543,389	41.66	2.19	266,865,517	58.34	5.16	457,408,906	3.86	65,085,565	14.23	10.35	20,575,057	4.
1924 [1]	278,340,981	48.40	28.97	235,597,474	40.97	23.65	339,432,888	59.03	27.19	575,030,362	25.71	62,527,586	10.87	-3.93	28,816,011	5.
								GRAND TOTAL								
1916	$2,136,468,625	25.59	----	$4,488,751,296	53.76	----	$3,861,150,687	46.24	----	$8,349,901,983	----	$2,051,324,363	24.57	----	----	
1917	2,848,842,499	23.59	33.34	7,607,107,930	62.98	69.47	4,469,901,354	37.01	15.77	12,077,009,284	44.64	885,763,077	7.33	-56.82	----	
1918	2,468,749,244	13.91	-13.34	12,897,846,872	72.68	69.55	4,847,914,601	27.32	8.46	17,745,761,473	46.93	1,821,122,118	10.26	105.60	----	
1919	2,453,774,825	10.94	-.61	17,464,037,635	77.83	35.40	4,973,648,190	22.17	2.59	22,437,685,825	26.44	2,578,194,377	11.49	41.57	----	
1920	2,735,845,795	10.25	11.49	21,197,700,892	79.42	21.38	5,492,568,961	20.58	10.43	26,690,269,853	18.95	2,954,640,670	11.07	14.60	----	
1921	2,476,952,399	10.62	-9.46	17,983,532,756	77.09	-15.16	5,345,249,176	22.91	-2.68	23,328,781,932	-12.59	3,751,569,404	16.08	26.97	----	
1922	2,664,219,081	10.71	7.56	18,952,242,862	76.20	5.39	5,919,665,492	23.80	10.75	24,871,908,354	6.61	3,110,477,655	12.51	-17.09	$425,218,169	1.
1923	3,126,503,482	10.66	17.35	21,817,380,809	74.41	15.12	7,501,546,994	25.59	26.72	29,318,927,803	17.88	3,942,031,526	13.45	26.73	536,758,913	1.
1924 [1]	3,207,181,311	10.98	2.58	21,740,503,155	74.42	-.35	7,474,260,513	25.58	-.36	29,214,764,668	-.36	3,663,111,077	12.54	-7.08	528,441,694	1.

[1] Returns filed up to Sept. 30, 1925.

,662,101,440	88.78	[illegible]	[illegible]	11.22	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]				[illegible]	[illegible]	[illegible]
,242,842,277	89.81	29.79	1,274,935,590	10.19	16.52	12,517,797,867	2.83	750,250,450	5.09	−3.13				11,767,547,417	94.01	31.[illegible]
,771,782,166	87.35	−39.77	980,750,886	12.65	−23.08	7,752,533,032	−38.07	704,626,799	9.00	−6.08				7,047,906,253	90.91	−40.11
,035,362,203	87.17	3.89	1,035,779,384	12.83	5.61	8,071,141,589	4.11	656,182,794	8.13	−0.87	$132,158,345	1.64		7,282,800,450	90.23	3.33
,404,780,343	80.97	19.46	1,975,087,412	19.03	90.69	10,379,807,755	28.60	1,052,810,916	10.14	60.44	182,006,769	1.75		9,145,050,070	88.10	25.57
,851,491,971	80.96	−6.58	1,846,486,251	19.04	−6.51	9,697,97[illegible],252	−6.57	985,118,542	10.16	−6.43	169,637,316	1.75	−6.80	8,543,222,394	88.09	−0.58

$5,000–$10,000

,048,270,762	68.98		$471,[illegible]	31.62		$1,519,664,082		$182,416,705	31.74					$1,047,247,977	69.26	
1,373,534,184	70.39	31.63	577,882,525	29.61	22.78	1,951,366,709	28.41	123,858,621	6.35	−74.33				1,827,508,088	93.65	76.19
1,866,057,694	71.32	51.49	726,382,276	28.68	25.70	2,592,189,970	29.78	386,699,954	15.27	212.21				2,115,090,618	84.73	17.41
2,726,065,040	78.10	50.94	764,275,202	21.90	5.22	3,490,340,242	37.83	536,162,989	15.36	38.65				2,954,147,253	84.64	37.68
2,778,125,619	76.84	1.91	837,118,157	23.16	9.54	3,615,243,776	4.55	546,912,793	15.13	2.01				3,068,330,963	84.87	3.87
2,093,184,885	73.17	−24.66	767,473,508	26.83	−8.32	2,860,658,253	−20.87	481,899,016	16.85	−11.89				2,378,759,237	83.15	−22.47
2,248,705,482	73.34	7.43	817,216,187	26.65	6.48	3,065,921,669	7.18	403,019,992	13.15	−16.37	$64,304,954	2.10		2,598,596,713	84.76	9.24
2,303,186,669	73.01	2.42	851,217,894	26.99	4.16	3,154,404,763	2.89	392,620,141	12.45	−2.58	65,379,816	2.07	1.67	2,696,404,548	85.48	3.76
2,611,041,839	78.45	13.37	717,232,181	21.55	−15.74	3,328,274,020	5.51	361,367,738	10.85	−7.20	57,743,490	1.73	−11.68	2,9[illegible]6,212,792	87.32	7.78

$10,000–$50,000

$1,348,147,064	54.78		$1,112,736,349	45.22		$2,460,883,213		$654,684,030	26.60					$1,806,200,183	73.40	
1,343,178,866	52.23	−0.37	1,228,792,681	47.77	10.43	2,571,971,547	4.52	157,788,859	6.13	−75.90				2,414,182,688	93.87	33.66
1,610,816,263	57.21	19.93	1,204,624,282	42.78	−1.97	2,815,440,785	9.47	389,131,464	13.82	146.62				2,426,309,324	86.18	.50
2,544,660,845	65.49	57.97	1,340,580,479	34.50	11.28	3,885,240,944	38.00	565,733,063	14.56	45.39				3,319,487,881	85.44	36.81
2,740,744,329	63.87	7.70	1,550,357,123	36.13	15.65	4,291,081,452	10.45	803,576,465	18.73	42.04				3,487,504,987	81.27	5.06
1,995,366,048	59.79	−27.20	1,341,793,124	40.21	−13.45	3,337,159,172	−22.23	668,636,056	20.04	−16.79				2,668,523,116	79.96	−23.48
2,197,026,105	59.03	10.11	1,524,757,213	40.97	13.64	3,721,783,318	11.53	739,664,548	19.90	−19.29	$73,267,830	1.97		3,108,912,140	83.53	16.50
2,489,369,726	58.73	13.31	1,749,249,165	41.27	14.72	4,238,618,891	13.89	617,765,177	14.57	11.47	89,245,072	2.11	21.80	3,531,608,642	83.32	13.60
2,807,610,562	61.27	12.78	1,774,903,025	38.73	1.47	4,582,513,617	8.11	543,645,355	11.86	−12.00	89,414,614	1.95	.19	3,949,453,548	86.19	11.83

$50,000–$100,000

$549,403,254	44.87		$674,836,982	55.12		$1,224,243,236		$249,970,501	20.42					$974,272,735	79.58	
486,521,981	39.36	−11.44	749,172,490	60.64	11.06	1,235,694,471	0.96	73,866,122	5.97	−70.48				1,162,128,349	94.03	19.29
517,835,461	45.60	6.44	617,699,672	54.40	−17.58	1,135,528,340	−8.13	167,526,367	14.75	127.60				968,002,173	85.25	−16.71
841,931,392	56.35	62.59	652,162,225	43.65	5.58	1,494,093,617	31.58	227,413,897	15.22	35.77				1,266,649,720	84.78	30.85
767,473,591	51.05	−8.84	735,739,446	48.95	12.82	1,503,213,037	.61	324,641,792	21.60	42.73				1,178,571,245	78.40	−6.95
511,925,945	46.92	−33.30	579,074,432	53.08	−21.29	1,091,000,377	−27.42	239,507,764	21.95	−26.22				851,492,613	78.05	−27.75
668,247,259	47.81	30.74	729,298,907	52.18	25.94	1,397,546,166	28.10	202,486,387	14.49	−15.46	$34,602,355	2.48		1,160,457,424	83.04	36.29
672,071,342	45.83	.57	794,387,588	54.17	8.92	1,466,458,930	4.93	214,366,273	14.62	5.88	40,727,905	2.78	17.70	1,211,364,652	82.60	4.38
840,792,572	48.07	25.10	908,251,916	51.93	14.33	1,749,044,488	19.27	202,430,321	11.57	−5.58	45,781,354	2.62	12.41	1,500,832,813	85.81	23.90

$100,000–$300,000

$433,142,931	41.80		$602,873,543	58.19		$1,035,996,474		$172,781,750	16.68					$863,214,724	83.32	
297,246,225	32.31	−31.37	622,837,637	67.69	3.31	920,083,862	−11.19	44,939,862	4.88	−73.99				875,144,000	95.12	1.38
282,655,909	40.67	−4.91	412,385,171	59.33	−33.79	695,041,080	−24.46	105,909,523	15.24	135.67				589,131,557	84.76	−32.68
463,902,671	52.02	64.12	427,910,905	47.98	3.76	891,813,576	28.31	162,272,117	18.20	53.22				729,541,459	81.80	23.83
272,202,090	42.87	−41.32	362,797,344	57.13	−15.22	634,999,434	−28.79	154,348,256	24.31	−4.88				480,650,178	75.69	−34.12
157,972,052	38.10	−41.97	256,689,509	61.90	−29.25	414,661,561	−34.70	105,192,515	25.37	−31.85				309,469,046	74.63	−35.61
285,738,791	43.82	80.88	366,267,200	56.18	42.69	652,005,991	57.24	102,207,076	15.68	−2.84	$22,780,981	3.49		527,017,934	80.83	70.30
272,292,231	40.65	−4.71	397,572,670	59.35	8.55	669,864,901	2.74	104,448,204	15.59	2.19	24,176,472	3.61	6.13	541,240,225	80.80	2.70
386,275,041	44.65	41.86	478,786,990	55.35	20.43	865,062,031	29.14	97,006,510	11.21	−7.12	28,430,012	3.29	17.59	739,625,509	85.50	36.65

$300,000 AND OVER

$406,270,290	35.24		$746,614,591	64.76		$1,152,884,881		$159,911,895	13.87					$992,972,986	86.13	
156,718,153	19.86	−61.43	632,564,023	80.14	−15.28	789,282,176	−31.54	57,910,023	7.34	−63.79				731,372,153	92.66	−26.35
136,006,340	27.54	−13.21	357,836,755	72.46	−43.43	493,843,095	−37.43	92,735,227	18.78	60.14				401,107,868	81.22	−45.16
218,601,665	39.97	60.73	328,360,613	60.03	−8.24	546,962,278	10.76	106,950,689	19.55	15.33				440,011,589	80.45	9.70
92,931,881	28.07	−57.49	248,091,908	71.93	−27.49	341,023,789	−39.48	84,669,204	25.58	−20.83				246,354,585	74.42	−44.01
47,137,904	22.32	−49.28	164,017,647	77.68	−31.11	211,155,551	−38.21	57,621,216	27.29	−31.95				153,534,305	72.71	−37.68
186,618,468	42.38	295.90	253,776,606	57.62	54.73	440,395,074	108.56	58,927,146	13.38	2.27	$15,738,182	3.57		365,724,746	83.05	138.21
190,543,589	41.66	2.10	266,865,517	58.34	5.16	457,408,906	3.86	65,085,565	14.23	10.35	20,575,077	4.50	30.73	371,748,264	81.27	1.65
235,597,474	40.97	23.65	339,432,888	59.03	27.19	575,030,362	25.71	62,527,556	10.87	−3.93	28,816,011	5.01	40.05	483,686,795	84.11	30.11

GRAND TOTAL

$4,438,751,296	53.76		$3,861,150,687	46.24		$8,349,901,983		$2,051,324,363	24.57					$6,248,577,620	75.43	
7,607,107,930	62.98	69.47	4,469,901,354	37.01	15.77	12,077,009,284	44.64	885,763,077	7.33	−56.82				11,191,246,207	92.67	77.68
12,897,846,872	72.68	69.55	4,847,914,601	27.32	8.46	17,745,761,473	46.93	1,821,122,118	10.26	105.60				15,924,639,355	89.74	42.30
17,464,037,635	77.83	35.40	4,973,648,190	22.17	2.59	22,437,685,825	26.44	2,578,194,377	11.49	41.57				19,859,491,448	88.51	24.71
21,197,700,892	79.42	21.38	5,492,568,961	20.58	10.43	26,690,269,853	18.95	2,954,640,670	11.07	14.60				23,735,629,183	88.93	19.52
17,983,532,756	77.09	−15.16	5,345,249,176	22.91	−2.68	23,328,781,932	−12.59	3,751,569,404	16.08	26.97				19,577,212,528	83.92	−17.52
18,952,242,862	76.20	5.39	5,919,665,492	23.80	10.75	24,871,908,354	6.61	3,110,477,655	12.51	−17.09	$425,218,169	1.71		21,336,212,530	85.78	8.98
21,817,380,509	74.41	15.12	7,501,546,994	25.59	26.72	29,318,927,803	17.88	3,942,031,526	13.45	26.73	536,758,913	1.83	26.23	24,840,137,364	84.72	16.42
21,740,503,155	74.42	−.35	7,474,260,513	25.58	−.36	29,214,763,668	−.36	3,662,111,077	12.54	−7.08	528,441,698	1.81	−1.55	25,023,210,893	85.65	.74