Revised Federal Income Tax Law

Cedric A. Major
The Revised Federal Income Tax Law

By Cedric A. Major

The revised Federal Income Tax Law, which increases the normal or primary tax rate from one to two per cent. and which differs in many particulars from the 1913 act and from the interpretation placed thereon, was enacted as a part of the General Revenue Measure of September 8, 1916, and became effective the following day. The new act repeals the 1913 statute and the so-called “War Revenue Stamp Taxes,” and except in certain specified instances applies for the entire year 1916.

Both statutes, the old and the new, were passed under the sanction of the sixteenth amendment to the federal constitution which became effective on February 25, 1913, and gave Congress power to “lay and collect taxes on incomes from whatever source derived without apportionment among the several States and without regard to any census or enumeration.” This amendment, as was held by the United States Supreme Court in Brushaber v. Union Pacific Railroad Company, and Stanton v. Baltic Mining Company, “conferred no new power of taxation but simply prohibited the previous complete and plenary power of income taxation possessed by Congress from the beginning from being taken out of the category of indirect taxation to which it inherently belonged and being placed in the category of direct taxation subject to apportionment by a consideration of the sources from which the income was derived, that is, by testing the tax not by what it was—a tax on income, but by a mistaken theory deduced from the origin or source of the income taxed.” Under this construction,—that an income tax is indirect and, hence, subject only to the requirement of geographical uniformity,—the previous law was held constitutional, and there can be but little doubt, therefore, as to the validity of the present law.

The provisions of the 1916 statute fall naturally into two groups: first, those relating to individuals, with specific reference to non-resident aliens, estates, fiduciaries and partnerships; second, those
relating to corporations. This analysis will deal with the law under the two main titles, "Individuals" and "Corporations," and will briefly refer to the particular provisions regarding nonresident aliens, estates, fiduciaries and partnerships in sub-headings under "Individuals." General provisions applying equally to corporations and individuals will be grouped at the end.

Within the limits of this article, it is possible only in a general way to treat of the provisions of the revised act and the particulars in which they differ from the former law and annul the rulings thereunder. It is further to be noted that future decisions of the courts and of the Treasury Department will likely affect the law's interpretation and application.

INDIVIDUALS

(i) Rates of Tax

The present, as well as the former, statute provides for a primary or normal tax which is levied upon the entire net income of individuals in excess of the specified personal exemptions, and also provides for a further additional tax or surtax which is levied in accordance with a graduated scale on incomes in excess of $20,000. The 1916 statute increases the primary tax rate from one to two per cent. and the additional tax rate from a maximum of six per cent. to a maximum of thirteen per cent. A comparison of the rates of the additional tax under both statutes and the amounts of income on which each rate is levied may be had from a reference to the following table:

<table>
<thead>
<tr>
<th>Present Law</th>
<th>Amount</th>
<th>Add'l Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>$ 20,000-40,000</td>
<td>1%</td>
<td></td>
</tr>
<tr>
<td>40,000-60,000</td>
<td>2%</td>
<td></td>
</tr>
<tr>
<td>60,000-80,000</td>
<td>3%</td>
<td></td>
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<tr>
<td>80,000-100,000</td>
<td>4%</td>
<td></td>
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<tr>
<td>100,000-150,000</td>
<td>5%</td>
<td></td>
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<tr>
<td>150,000-200,000</td>
<td>6%</td>
<td></td>
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<tr>
<td>200,000-250,000</td>
<td>7%</td>
<td></td>
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<tr>
<td>250,000-300,000</td>
<td>8%</td>
<td></td>
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<tr>
<td>300,000-500,000</td>
<td>9%</td>
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<tr>
<td>500,000-1,000,000</td>
<td>10%</td>
<td></td>
</tr>
<tr>
<td>1,000,000-1,500,000</td>
<td>11%</td>
<td></td>
</tr>
<tr>
<td>1,500,000-2,000,000</td>
<td>12%</td>
<td></td>
</tr>
<tr>
<td>In excess of 2,000,000</td>
<td>13%</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Former Law</th>
<th>Amount</th>
<th>Add'l Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>$ 20,000-50,000</td>
<td>1%</td>
<td></td>
</tr>
<tr>
<td>50,000-75,000</td>
<td>2%</td>
<td></td>
</tr>
<tr>
<td>75,000-100,000</td>
<td>3%</td>
<td></td>
</tr>
<tr>
<td>100,000-250,000</td>
<td>4%</td>
<td></td>
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<tr>
<td>250,000-500,000</td>
<td>5%</td>
<td></td>
</tr>
<tr>
<td>In excess of 500,000</td>
<td>6%</td>
<td></td>
</tr>
</tbody>
</table>

The method of computing the tax remains the same, though due to the increased rates the amount required of each tax payer will be nearly doubled. Under the present law a bachelor having a taxable

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4Sec. 1-a.
net income of one million dollars is required to pay $102,940 thereof to the government, whereas he was taxed but $60,020 under the 1913 statute. The tax would now be computed as follows:

$1,000,000 taxable net income
3,000 personal exemption

$997,000, taxable at normal rate, 2% .......................... = $ 19,940
20,000 (20,000–40,000) at 1% additional .................. = 200
20,000 (40,000–60,000) at 2% “ ............................ = 400
20,000 (60,000–80,000) at 3% “ ............................ = 600
20,000 (80,000–100,000) at 4% “ .......................... = 800
50,000 (100,000–150,000) at 5% “ .......................... = 2,500
50,000 (150,000–200,000) at 6% “ .......................... = 3,000
50,000 (200,000–250,000) at 7% “ .......................... = 3,500
50,000 (250,000–300,000) at 8% “ .......................... = 4,000
200,000 (300,000–500,000) at 9% “ .......................... = 18,000
500,000 (500,000–1,000,000) at 10% “ .......................... = 50,000

$102,940

The new rates of normal and additional taxes apply to incomes of individuals and corporations for the entire year 1916, notwithstanding the fact that the law was not enacted until September 8, 1916, but withholding agents shall deduct only one per cent. at the source until January 1, 1917, the individual being liable for the remaining one per cent. In the 1913 statute there was a similar retroactive feature which was held constitutional by the United States Supreme Court in Brushaber v. Union Pacific Railroad Company, and in Tyee Realty Company v. Anderson, the reason being as stated by Chatfield, District Judge, in Edwards v. Keith, 1

"If the person is liable for the tax in the future, the method of its computation as estimated upon the past does not invalidate the tax."

In view of these decisions there can be little doubt but that the similar provision of the present law is valid.

(2) Income

"Income" is defined to include gains, profits and income from every source whatever and specifically from: (a) salaries, wages and compensation; (b) professions, vocations, business, trade, commerce, sales or dealings in property; (c) interest, rent, dividends.

Under the 1913 law, as construed by the Treasury Department, dividends were taxed as of the date of their distribution irrespective of

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1Sec. 1-c.
1Sec. 10.
1Sec. 8-d.
1Supra, note 2.
1240 U. S. 115.
1224 Fed. 585, at page 587.
1T. D. 2163, 2274.
of whether they accrued prior or subsequent to March 1, 1913, the effective date of the statute. The new act in effect establishes a different test for determining the taxability of dividends in that it makes the time of the accrual of the earnings out of which the dividends are paid the controlling factor. Under the new act if the earnings out of which the dividends, whether in cash or in stock, are paid, accrued subsequent to March 1, 1913, then the dividends are taxable, but if the earnings accrued prior to that date no dividends therefrom are taxable.

In determining the cash value of a taxable dividend paid in stock the amount of earnings so distributed is controlling: e.g., if a company distributes five hundred shares of stock from earnings of $50,000, then each share represents an income of one hundred dollars, and the recipient must include the same in that amount as income in his return.

Profit or loss from the sale of property acquired prior to March 1, 1913, is now computed by deducting the fair market price or value on that date from the selling price, or vice versa. Formerly the law was silent, and the Treasury Department ruled that the original cost be taken and the profit or loss be apportioned pro rata for the period elapsed after March 1, 1913 in the case of individuals, and for the period elapsed after January 1, 1909, in the case of corporations. This ruling, however, as well as that of T. D. 2163 and 2274, supra, is apparently nullified by the decision of the Circuit Court of Appeals in Lynch v. Turrish,17 overruling United States v. Cleveland C. C. and St. Louis Railway Co. Sanborn, Circuit Judge, writing the opinion of the court, says: "The enhanced value of property which accrues from the gradual increase in its value during a series of years prior to the effective date of an income tax law, although divided or distributed by dividend or otherwise subsequent to that date does not become income, gains or profits taxable under such an act. Such enhanced value, like the property of which it is an outgrowth and in which it adheres, becomes the absolute property of its legal and equitable owners before the effective date of the law and as against such a law thereafter remains their capital assets."

This decision may prove important to those who have paid under the former statute a tax on dividends ordered out of earnings accrued

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1Sec. 2-a.
3Sec. 2-c.
4Sec. 5-a-fourth.
5T. D. 2090, 2291.
7Southern District, Ohio, decided Feb. 23, 1916.
prior to March 1, 1913, or a tax on enhanced value of property accrued prior to that date. The decision as to taxes hereafter paid under the 1916 act is not important because as stated above the provisions of that law make the value as of March 1, 1913, the determining factor.

The additional tax is levied upon the undistributed profits of corporations or associations organized to escape the tax by permitting the accumulation of profits beyond the needs of business.\(^1\)

It is worthy of notice that in the case of bonds purchased with accrued interest the department has ruled that the owner of the bonds at the time the interest becomes due should account in his return only for the interest which accrued after the bonds were purchased by him. The former owner should account in his return for the interest which accrued during his ownership of the bonds.\(^2\)

(3) **Exempt Income**

The following income is exempt from the provisions of the law:

(a) Proceeds of life insurance policies paid to individual beneficiaries upon the death of the insured.\(^2\)

(b) Return premiums (commonly called "dividends") which were previously paid by the insured under life insurance, endowment or annuity contracts.\(^2\) However, "dividends" from paid up policies are considered income.\(^2\)

(c) Value of property acquired by gift, bequest, devise, or descent, although the income of such property is not exempt.\(^2\)

(d) The interest upon the obligations of a state or any political subdivision thereof (including municipal bonds) or of the United States or its possessions, or securities issued under the Federal Farm Loan Act. The interest upon such obligations need not under the present ruling be accounted for in the return.\(^2\)

(e) "The compensation of the present President of the United States during the term for which he has been elected." Apparently after March 4, 1916, the salary of the president will not be exempt. The compensation of the judges of the federal courts now in office. The salary of officers or employees of a state or political subdivision thereof.\(^2\)

(4) **Deductions**

(a) Necessary expenses of business or trade, not including personal, living or family expenses.\(^2\) Premiums paid on life insurance

\(^1\)Sec. 3.
\(^2\)Ruling contained in letter to Corporation Trust Company, Feb. 5, 1915.
\(^2\)Sec. 4.
\(^2\)Sec. 4.
\(^2\)T. D. 2137.
\(^2\)Sec. 4.
\(^2\)Sec. 4.
\(^2\)T. D. 1892, 1946.  \(^2\)Sec. 4.  \(^2\)Sec. 5-a.
policies do not constitute an allowable deduction. It is interesting to note that the department has ruled that salaries paid to employees, members of the national guard, while in federal service will be considered a necessary expense of business.

(b) Interest paid on taxpayer's indebtedness.

(c) Taxes including those paid under authority of a foreign government excluding those assessed against local benefits. Under this heading the income tax paid for the previous year and also the amount of same withheld at the source is a proper deduction.

A state inheritance tax, being a charge against the corpus of the estate, is not a proper deduction to either the estate or the beneficiary thereof.

(d) "Losses actually sustained during the year incurred in business or in trade or arising from fires, storms, shipwreck or other casualty and from theft" when not covered by insurance. The italicized portion is new and, seemingly, is broad enough to authorize a deduction for losses not incurred in business as for example, loss due to the theft or destruction of jewelry or a private automobile. The department, however, has ruled otherwise unofficially and, though the language used must be considered broad enough, it is not likely that Congress intended to authorize deduction for personal losses.

(e) Losses in transactions not connected with taxpayer's business or trade to an amount not exceeding the profits therefrom.

Under the previous law the Treasury Department held that losses incurred in transactions and dealings not connected with the taxpayer's business were not deductible, even though the profits arising therefrom were required to be included as taxable income. This ruling was palpably inequitable and is nullified by the present statute. Now the taxpayer is chargeable only with the net gain derived from such transactions. This change will prove, particularly in this year of unusual market activity, of considerable benefit to those dealing in securities. Now, if a man makes $50,000 in the market and loses $100,000 he will not be required to pay any tax by reason thereof, whereas previously he was taxed on the $50,000 and received no deduction whatever for the $100,000 loss. In such a case, however, the taxpayer would not be permitted to set off his net loss of $50,000 as a deduction against his other income—he may not deduct a net loss and is now chargeable only with a net gain.

29T. D. 2090.
31Sec. 5-a.
32Under former law no deduction for foreign taxes—T. D. 2090.
33Sec. 5-a.
34T. D. 2135.
35Sec. 5-a.
37T. D. 2135.
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(f) Debts charged off within the year.37

(g) A reasonable allowance for depreciation of property employed in the business or trade. Special rules in the case of oil and gas wells and mines.38 No deductions for new buildings or permanent improvements.39 It has been ruled, however,40 that, in addition to the depreciation deduction intended to cover the cost of the property as a whole, the expense of incidental repairs, which do not add to the value of the property but merely keep it in an operating condition, is an allowable deduction.

(5) Credits

The new law41 requires that dividends be included in the return, but section 5-b allows a credit to the amount of such dividends received from corporations organized or operating in the United States. This credit is allowed for the reason that the dividends represent an earning of the corporation on which the corporation itself is required to pay the tax. Nonresident corporations, however, are not subject to a tax, under this act, on any earnings derived from sources without the United States, and therefore dividends paid out of such earnings are taxable in the hands of residents or citizens for normal as well as additional taxes.

The act42 likewise allows a credit for the purpose of the normal tax to the amount of the income the tax upon which has been paid or withheld at the source.

(6) Personal Exemptions

Although considerable pressure was brought to bear, Congress refused to reduce the amount of the specific exemptions, and the revised statute continues to allow a personal exemption of three thousand dollars to each unmarried person and four thousand dollars to a married person living with husband or wife; not more than a total of four thousand dollars to be claimed by a husband and wife living together.43

The former law is changed in that the four thousand dollar exemption is now allowable not only to a husband and wife living together but also to the head of a family.44

37Sec. 5-a.
38Sec. 5-a.
39Sec. 5-a.
40Art. 81, Reg. 33.
41Sec. 8f.
42Sec. 5-c.
43Sec. 7-a.
44Sec. 7-a.
In respect to the computation of the additional tax on the incomes of husband and wife, the Treasury Department has ruled that such income shall be taxed separately and not as a single income.\(^4\)

(7) Annual Returns

Every person of lawful age, having a net income of three thousand dollars or over for the calendar year, is required to make a return under oath (former law also permitted affirmation), and this is so notwithstanding the fact that such person may have a specific exemption of four thousand dollars.\(^4\) All returns must be filed on or before March first of each year for the preceding calendar year with the collector of the district in which the taxpayer has his residence or principal place of business.\(^4\)

The revised law\(^4\) specifically requires that the return include income derived from dividends of corporations and associations. This provision, however, is apparently for statistical purposes only, because, as has been previously noted (see section on credits, supra), for the purpose of the normal tax a credit is granted to the amount of dividends received from domestic corporations, and therefore the individual pays no tax thereon. Under the previous law it was ruled\(^4\) that an individual, unless subject to the additional tax, was not required to report dividends of corporations organized or operating in the United States.

The Commissioner of Internal Revenue\(^6\) may grant a reasonable extension of time for filing returns to persons residing or travelling abroad. The collector may also allow an extension not to exceed thirty days on account of sickness or absence.\(^5\) In addition, the new law\(^6\) authorizes the commissioner to grant a reasonable extension of time (apparently without regard to the thirty day limit) in meritorious cases.

A person who is unable to make his annual return because of illness, absence or nonresidence may\(^5\) have such return made by an agent in his behalf, but the agent must assume all responsibility in reference thereto, including the penalties provided for erroneous, false or fraudulent returns.

\(^{4T. \ D. \ 2090.}\)
\(^{4Sec. \ 8a \ and \ b.}\)
\(^{4Sec. \ 8-b.}\)
\(^{4Sec. \ 8-f.}\)
\(^{4T. \ D. \ 1945.}\)
\(^{4Sec. \ 8-b.}\)
\(^{4Sec. \ 14-c.}\)
\(^{5Sec. \ 15; \ R. \ S. \ sec. \ 3176.}\)
\(^{5Sec. \ 14-c.}\)
\(^{5Sec. \ 8-b.}\)
An individual keeping accounts upon any basis other than that of actual receipts and disbursements may make his return upon such basis provided it clearly reflects his income.\textsuperscript{54}

(8) Assessments

On or before June first of each year the government will notify the tax payer of the amount of his assessment, and he must pay the same on or before June the fifteenth instead of June thirtieth, as permitted by the former law.\textsuperscript{55} Erroneous, false or fraudulent returns may be corrected by the government at any time within three years.\textsuperscript{56}

(9) Deduction at Source\textsuperscript{57}

The provisions in this regard are substantially the same as in the old law. Persons, firms, corporations, co-partnerships, companies and associations in any way entrusted with the fixed or determinable annual or periodic income of another person exceeding three thousand dollars for any taxable year, other than income derived from dividends of taxable corporations hereunder are authorized and required to deduct the normal tax from such income.\textsuperscript{68} In addition to the general provisions the duty of withholding is specifically placed upon lessees, mortgagors, trustees, executors, receivers and employers.\textsuperscript{59}

The withholding agent is made personally liable in case of failure to withhold the tax and is required to make a return of the tax withheld, and must state the name and address of the person, if known, and must pay the tax to the federal government.\textsuperscript{60}

Both statutes—the former and the revised—require\textsuperscript{61} that the normal tax shall be deducted and withheld from fixed annual or periodical gains and income derived from interest upon bonds, etc., of corporations and associations although such interest does not amount to three thousand dollars.

Likewise both statutes provide\textsuperscript{62} that the normal tax shall be deducted at the source on coupons, checks or bills of exchange in payment of interest and dividends on foreign obligations, although such interest or dividends do not exceed three thousand dollars by:

\textsuperscript{54}Sec. 8-y.
\textsuperscript{55}Sec. 9-a.
\textsuperscript{56}Sec. 9-a.
\textsuperscript{57}See also this heading under Corporations No. 7.
\textsuperscript{58}Sec. 9-b.
\textsuperscript{59}Sec. 9-b.
\textsuperscript{60}Sec. 9-b.
\textsuperscript{61}Sec. 9-c.
\textsuperscript{62}Sec. 9-d.
(a) Any bank or person who shall sell or otherwise realize coupons, etc., in payment of any such interest or dividends (not payable in the United States).

(b) Any person who shall obtain payment in the United States in behalf of another of such dividends and interest by means of coupons, checks or bills of exchange.

(c) Any dealer in such coupons who shall purchase the same otherwise than from a banking house or other dealer in such coupons.

Under penalty of fine or imprisonment or both, all persons, firms or corporations undertaking as a matter of business or for profit the collection of foreign payments of such interest or dividends shall obtain a license from the Commissioner of Internal Revenue.6

(10) Method of Claiming Specific Exemption and Deductions

The statute provides that no person shall receive the benefits of the specific exemption of $3,000 or $4,000 except by an application for a refund, unless he shall file an appropriate claim with the withholding agent not less than thirty days prior to March the first following the tax year.

Likewise no person shall be allowed the benefits of any of the authorized deductions unless he shall file with the withholding agent or with the proper collector not less than thirty days prior to the day on which the return is due a statement in substantially the form of his annual return claiming the deductions asked for. Obviously such a statement could not be prepared until the close of the year. To meet the inconvenience caused by this method of claiming deductions the new statute further provides that when any amount allowable as a deduction is known at the time of receipt of any fixed annual or periodical income the taxpayer may then file with the withholding agent an appropriate statement claiming the allowance and thereupon the payment shall be made without deduction of tax. It would seem that under this provision of the new law a landlord, for instance, might file with his tenant at the time of any monthly payment of rent a claim for deduction on account of taxes, operating expenses, etc., incurred up to that time and the tenant would then be authorized to file such claim with the government in lieu of the amount of tax he would otherwise be required to withhold.

A. Provisions Particularly Relating to Nonresident Aliens

The present law provides that nonresident aliens shall be taxed on net income received from all sources within the United States
and specifically includes income derived from interest on bonds or other obligations of resident organizations and individuals.  

The new statute (sec. 6-a) provides for nonresident aliens a separate list of deductions which are substantially the same as those allowed citizens or residents except that the deductions granted a nonresident alien are in respect only to his business or interests in the United States. He is also specifically granted the privilege allowed citizens and residents of setting off as credits dividends of domestic corporations and also all amounts of income the tax upon which has been paid or withheld at the source.

The Treasury Department under the 1913 law ruled that a nonresident alien was not entitled to a personal exemption. The new statute provides specifically that he is entitled to such exemption upon his filing with the collector a return of his total income from all sources within the United States. He is not, however, entitled to such exemption until after the close of the tax year and then only by way of refund.

The responsible heads, agents or representatives of nonresident aliens who are in charge of the property owned or business carried on within the United States are required to make a return of the income therefrom and to pay the tax assessed upon such income received by them in behalf of their nonresident alien principals.

B. Provisions Particularly Relating to Estates and Fiduciaries

Estates and trusts are treated as an entirety and are taxed as such for the period of administration or settlement, the tax in each instance being assessed against the executor or trustee. However, income distributed to beneficiaries regularly is subject only to the tax on the individual shares. Guardians, executors and all other persons, corporate or otherwise, acting in a fiduciary capacity, are required to make a return of the income of a person, trust or estate for whom or for which they act when the annual taxable income of any beneficiary from the estate is in excess of three thousand dollars.

A ward or beneficiary under a trust may secure the benefit of the specific exemption of three thousand or four thousand dollars by

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67Sec. 1-a.
68Sec. 6-b.
69Art. 6, Reg. 33, T. D. 2109.
70T. D. 2313.
71Sec. 2-b.
72Sec. 2-b.
73Sec. 8-c.
filing the proper certificate. The act also grants an exemption from the amount of net income of estates and trusts during the period of settlement of three thousand dollars "including such deductions as are allowed under section 5" (the section specifying the several deductions granted individuals). The meaning of this provision is not clear and there will probably be rulings upon it by the Treasury Department.

C. Provisions Particularly Relating to Partnerships

Partnerships as such (except limited partnerships, which are taxed as corporations) are not taxable, but the members thereof are liable individually for their share of the firm's profits, whether divided or undivided, and are required to include such income in their individual returns.

The present act provides that from the net distributive interest of the individual partners in the firm profits there shall be excluded, for the purpose of the tax, the proportionate shares of the following: (a) Interest on obligations of the United States and its possessions or of a state or any political subdivision thereof. (b) Domestic taxes. (c) Dividends of resident corporations.

Subdivisions (a) and (c) above result in a departure from the rulings under the 1913 Act. Formerly a partner was not permitted to deduct his proportionate share of the income derived by the partnership from interests on state and federal obligations and on dividends from resident corporations.

It is to be noted that as regards partnerships, the present statute is silent as to the several deductions specifically granted individuals, such as foreign taxes, expenses of business, interest on indebtedness, losses, etc. The Treasury Department will in all probability soon rule on these points.

The Attorney General held under the former law that income due to partnerships is not subject to deduction at the source. This is true under the present law except that the tax must now be withheld for payment at the source on interest due partnerships not having an office or place of business within the United States.
II. CORPORATIONS

(1) Rates of Tax

As in the case of individuals, the revised statute increases the tax rate to corporations from one to two per cent. No specific exemption is granted corporations, but additional taxes are not imposed.

The revised law and the two per cent. tax thereby imposed apply to income for the year 1916 except that a corporation which has its fiscal year different from the calendar year, is required to pay the two per cent. tax on the proportion of its net income within the period between January first and the end of its fiscal year bears to the whole of such fiscal year.

(2) Income

Domestic organizations are taxable on their net income from all sources within and without the United States; foreign organizations only on such income as is derived from sources within the United States. The new law specifically provides that foreign organizations are taxable on interest and dividends of resident organizations. Limited partnerships, it has been ruled, are taxable as corporations.

The new act, for the purpose of determining the taxable income of corporations, as in the case of individuals, defines dividends to include any distribution, whether in cash or in stock, made or ordered to be made, by a corporation or association out of its earnings which accrued after March 1, 1913. The Circuit Court of Appeals has held, in an opinion rendered February the fourth, 1916, in the case of Lynch v. Turrish, that dividends declared or assets distributed subsequent to March 1, 1913, from profits acquired prior to that date do not constitute taxable income. Likewise profit or loss from the sale by a corporation of property acquired by it prior to March 1, 1913, is now computed by deducting the fair market price or value on that day from the selling price, or vice versa.

(3) Corporations Exempt from Tax

Under the 1913 act nine different kinds of corporations and organizations were exempted from all the requirements of the act including the duty of withholding at the source. The present act, though it exempts from the payment of the tax fourteen different kinds of organizations not conducted for the profit of their individual members,
such as religious, charitable, educational, agricultural, pleasure and labor associations, clubs and certain mutual companies, yet it holds (T. D. 2407) these organizations subject to the provisions of the act requiring deduction of the tax at the source and payment of the same to the government.

Both statutes further provide that no tax shall be levied on income derived by a state from any public utility or from the exercise of any essential governmental function or under any contract entered into prior to the passage of the law with any person or corporation for the acquisition, construction, operation or maintenance of such public utility, the exemption, however, not to extend to the income of such person or corporation.93

(4) Exempt Income

Corporations are not granted any specific exemptions such as are allowed individuals. It has been ruled,94 however, that income accruing to corporations, as well as to individuals, from interest on obligations of the United States or its possessions or a state or any political subdivision thereof, is exempt from the provisions of the act.

(5) Deductions95

Domestic organizations in general are allowed the following deductions:96

(a) Expense of the maintenance and operation of its business and properties, including rentals of property to which the corporation has no title or equity.

It is worthy of note that the Treasury Department has ruled97 that premiums paid by corporations on insurance policies in their favor on the lives of their officers are allowable deductions.

(b) Losses charged off within the year, including a reasonable allowance for depreciation.

No allowance permitted for new buildings or permanent improvements.

Special rules in the case of oil and gas wells, mines and insurance companies.

(c) The new law provides that interest paid within the year on a corporation's indebtedness is deductible to an amount not exceeding the sum of (1) its entire paid up outstanding capital stock and (2) one-half its outstanding interest bearing indebtedness; and further provides that preferred capital stock shall not be considered interest bearing

93Sec. 11-b. 94T. D. 2137.
95See also this heading under Individuals No. 4.
96Sec. 12-a. 97T. D. 2090.
indebtedness and interest or dividends paid on such stock shall not be deductible from gross income. In the case of a corporation the stock of which has no par value the amount of paid up capital stock within the meaning of the section will be the amount of cash or its equivalent paid or transferred to the corporation as a consideration for such shares. The provisions of this paragraph, though the language used is much clearer, make no change in the interpretation placed by the government on the like section of the former law.

Special rule in computing interest on indebtedness wholly secured by collateral, the subject of sale in the ordinary business of the corporation.

In the case of bonds or other indebtedness which have been issued with a guaranty that the interest payable thereon shall be free from taxation, no deduction is allowed for the payment of the income tax or any other tax paid pursuant to such guaranty.

Banking companies are allowed to deduct interest paid on deposits.

(d) Foreign, federal and state taxes, including those imposed under authority of school district, principality, or other subdivision, but not including those assessed against local benefits.

The new statute, as in the case of nonresident alien individuals, provides for foreign organizations a separate list of deductions which are substantially the same as those allowed resident organizations, except that the deductions granted foreign organizations are in respect only to their business or interests in the United States.

(6) Annual Returns

The calendar year is made the tax year for corporations as well as for individuals, but both statutes authorize a corporation to designate the last day of any month as the close of its fiscal year by giving notice of the day thus designated to the collector not less than thirty days prior to March first.

It is required that the return be sworn by the president, vice-president or other principal officer and by the treasurer or assistant treasurer, and filed with the collector of the district in which is located the principal office of the organization on or before March the first, or in the case of a corporation having a fiscal year other than the calendar year not later than sixty days after the close of such fiscal year.

 Receivers, trustees in bankruptcy or assignees must make returns for the property or business of the corporations they are operating.

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9Sec. 12-b. 99Sec. 13-a. 100Sec. 13-b. 101Sec. 13-c.
As in the case of individuals, the revised statute\textsuperscript{102} permits corporations keeping accounts upon a basis other than that of actual receipts and disbursements to make returns upon such basis, provided it clearly reflects the corporation's income.

Under the previous law\textsuperscript{103} it was ruled by the Treasury Department that the collector in the case of sickness or absence of an officer might grant an extension of not more than thirty days for filing the return. The present law\textsuperscript{104} specifically authorized the Commissioner of Internal Revenue to grant in meritorious cases a reasonable extension of time for filing the returns of corporations. Apparently under the new law in a proper case the extension may be for more than thirty days.

\section{Deductions at the Source}

Whether a debtor organization shall deduct at the source the tax on salaries, interest, dividends, etc., paid out by it to others, whether individuals or corporations, depends on three things: first, the character of the payee,—whether an individual, a partnership or a corporation; second, the citizenship or residence of the payee,—whether a citizen, resident or nonresident alien, or a resident or nonresident alien corporation; and third, the nature of the income,—whether salary, wages, etc., or interest or dividends.

\subsection{Income Payable to Individuals}

\subsubsection{Where the Individual is a Citizen or Resident}

(a) Where the income is derived from \emph{rents, salaries, premiums, annuities, compensation, remuneration, emoluments, or interest}, the debtor organization is required to withhold the amount of the tax at the source, provided such income is fixed or determinable annually or periodically, and exceeds three thousand dollars.\textsuperscript{105}

Where the rents, salaries, etc. are paid monthly or periodically during the year, then the debtor organization should not withhold the tax until such time as the rents, salaries, etc. reach an aggregate amount in excess of three thousand dollars. When such amount has been reached, then the debtor organization should withhold the tax on the entire three thousand dollars and any excess thereof unless the payee files a notice claiming exemption, in which case the debtor should withhold only the tax on the income in excess of the exemption claimed (Art. 65, Reg. 33).

(b) Where the income is derived from \emph{interest} on bonds or other obligations the tax must be withheld regardless of the amount of such interest.\textsuperscript{106}

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{102}Sec. 13-b.
\item \textsuperscript{103}Art. 173, Reg. 33.
\item \textsuperscript{104}Sec. 14-c.
\item \textsuperscript{105}Sec. 9-b.
\item \textsuperscript{106}Sec. 9-c.
\end{itemize}
\end{footnotesize}
(c) Where the income is derived from dividends the tax should not be withheld. The tax, however, must be withheld from coupons, checks, etc., in payment of foreign interest and dividends.

(2) Where the Individual is a Nonresident Alien

(a) Rents, etc.
Same as in the case of citizens or residents.

(b) Interest.
Same as in the case of citizens or residents.

(c) Dividends.
Same as in case of citizens or residents.

Under the former law it was held by the Treasury Department that a nonresident alien was taxable on dividends irrespective of the amount thereof and it was therefore required that a tax thereon be deducted at the source.

B. INCOME PAYABLE TO PARTNERSHIPS

(1) Where resident, the tax should not be withheld no matter what the nature of the income.

(2) Where nonresident alien and not engaged in business or trade within the United States and not having any office or place of business therein:

(a) Where the income is derived from interest on bonds and other obligations of resident organizations the tax should be withheld.

(b) Where the income is derived from dividends of resident organizations the tax should not be withheld.

C. INCOME PAYABLE TO CORPORATIONS

(1) Where resident, the tax should not be withheld no matter what the nature of the income.

(2) Where nonresident alien and not engaged in business or trade within the United States and not having any office or place of business therein the debtor organization is required to deduct the tax from both interest and dividends.

Section 13-f makes a marked innovation, for under the 1913 statute a deduction at the source was not required as to any income payable to corporations, whether resident or otherwise, while now it is clear that the tax must be withheld on interest and dividends payable to nonresident alien corporations. To enable debtor corporations to distinguish between nonresident alien corporations which have and those which do not have "any office or place of

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106 Sec. 5-b.
109 Sec. 9-c.
113 Sec. 13-e.
116 Sec. 13-b.
119 Sec. 13-f.
122 Sec. 13-e.
125 Sec. 13-f.
128 Sub-div. e and art. 29, reg. 33.
business" in the United States, the Treasury Department has authorized a certificate, form 1086, which will serve to identify those foreign corporations which are exempt from the withholding provision. Unless such certificate is filed the debtor organization should deduct the tax.

The revised statute provides that until January 1, 1917, the former law shall govern the amount to be deducted at the source. Accordingly, until that date, the debtor corporation is required to deduct but one per cent the payee being liable for the remaining one per cent.

Thereafter, the debtor corporation will be required to deduct the normal tax at the rate of two per cent on all income subject to withholding paid out by it on or subsequent to January 1, 1917, regardless of the date on which the income became due and payable.

(8) Assessments

On or before June first of each year, the government will notify the taxpaying corporation of the amount of assessment and it must pay the same on or before June the fifteenth. It is to be noted that this section changes the former law in that it requires payment on the fifteenth instead of the thirtieth of June.

Corporations whose fiscal years are different from the calendar year must file their return within sixty days and must pay their tax within one hundred and sixty-five days after the close of their fiscal year.

III. GENERAL PROVISIONS

(a) Procedure and Appeal

Heretofore claims for refund of taxes improperly collected were subject to a two-year statute of limitation. The revised law, however, permits taxpayers, corporate as well as individual, where it is discovered upon an examination of the return that excessive taxes have been paid, to present claims for a refund of the excess tax notwithstanding more than two years have elapsed since the right to refund accrued. This section, under a construction placed thereon by the Treasury Department, also removes from the bar of the two-year statute of limitation all claims for a refund of taxes improperly collected under the Acts of 1909 (Corporation Tax Act) and 1913. Claims heretofore rejected because barred by the two-year statute can now be reopened provided it appears from an
examination of the returns in question, that taxes in excess of those properly due have been paid.

A party who deems himself aggrieved by the imposition of the tax may appeal to the Commissioner of Internal Revenue for redress. In case the Commissioner decides against him or delays decision for more than six months, then, and not until then, may the taxpayer resort to the courts. The bill of complaint in a suit to recover taxes wrongfully collected should, therefore, allege a compliance with the provisions of the revised statute, viz., that an appeal was taken to the Commissioner of Internal Revenue after the payment of the taxes and that he refused to refund.

Section 3224 of the Revised Statutes provides "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court." This section, the United States Supreme Court has decided in the case of Dodge v. Osborn, is applicable to taxes imposed by the Income Tax Law and that the doctrine that "a suit may not be brought to enjoin the assessment or collection of a tax because of the alleged unconstitutionality of a statute imposing it" is no longer open to question. It is therefore clear that the remedy is by a suit to recover back the tax after it is paid and that a suit to restrain its collection is forbidden.

In considering the question of the proper defendant in an action to recover taxes improperly collected, it is important to note the decision of the United States District Court for the Southern District of New York in the case of Roberts v. Lowe, decided in November, 1916. There it is held that where the collector to whom the tax was paid is no longer in office, a suit to recover the same can not be maintained against his successor. The remedy lies in either an action against the collector who actually received the taxes, or in an action against the United States.

(2) Penalties

Where the tax is unpaid after June fifteenth and for ten days after notice and demand by the collector, five per cent. will be added to the amount thereof, and also interest at one per cent. a month from the time the tax became due.

For a failure to render a return within the proper time there will be added to the tax fifty per cent. of its amount, except that when a

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128Sec. 19.
129R. S. 3226.
131240 U. S. 118.
14Individuals, sec. 9-a; Corporations, sec. 14-a.
return is voluntarily made after such time and it is shown that the
failure to file was due to a reasonable cause, then no such addition
will be made. When the return is false or fraudulent, the amount
of the tax will be doubled.\textsuperscript{132}

The law further imposes a penalty of not less than twenty or more
than one thousand dollars on individuals\textsuperscript{133} refusing or neglecting
to render a return; and a penalty of not exceeding ten thousand
dollars on corporations\textsuperscript{134} refusing or neglecting to make a return or
rendering a false or fraudulent return.

A penalty of three hundred dollars is provided for filing a false
claim of personal exemption\textsuperscript{135} and an individual or corporate officer
making a false or fraudulent return is declared guilty of a misdemeanor
and becomes liable to a fine of not exceeding two thousand dollars,
one year's imprisonment, or both, together with costs.\textsuperscript{136}

\textbf{(3) Revenue Produced by the Act}

For the year 1916 the collections amounted to $124,937,252.61,
and for 1915, $80,201,758.86. The cost of collection in 1916 amounted
to $7,190,000 as compared with $6,804,688.77 for the previous year.

In 1916 the income tax receipts from corporations were
$56,972,676.10, and from individuals $67,943,639.41. The "individual" item was made up of $23,995,777.28 as normal tax and
$43,947,876.35 as surtax.

It is of interest to note that the State of New York in 1916 con-
tributed $45,200,057.85 (from corporations $14,947,802.46, from
individuals $30,252,255.39), or nearly thirty-six per cent of the total
income tax receipts of the government.

\textsuperscript{132}Sec. 16.
\textsuperscript{133}Sec. 18.
\textsuperscript{134}Sec. 14-e.
\textsuperscript{135}Sec. 9-b.
\textsuperscript{136}Sec. 18.