If a subscriber wishes his subscription to the Review discontinued at its expiration, notice to that effect should be sent; otherwise it is assumed that a continuation is desired.

Subscription Price $2.50 per volume $1.00 per current number

EDITORIAL BOARD
Hiram H. Lesar, Faculty Chairman

STUDENTS
Ernst Frederick Beihl, JR. Andrew H. LaForce, II
Richard W. Dahms Allen S. Parish
Thomas D. Dwyer Eugene E. Reeves
Leo E. Eickhoff, JR. Isaac N. Skelton
Robert S. Gardner Stephen E. Strom, Chairman
James H. Harrington Thomas G. Strong

Publication of signed contributions does not signify adoption of the views expressed by the Review or its Editors collectively.

"My keenest interest is excited, not by what are called great questions and great cases, but by little decisions which the common run of selectors would pass by because they did not deal with the Constitution or a telephone company, yet which have in them the germ of some wider theory, and therefore of some profound interstitial change in the very tissue of the law."—Oliver Wendell Holmes, Collected Legal Papers (1920) 269.

Legislation


Although the new code accomplishes a complete revision of the law, the alterations which become of most importance to the individual taxpayer are those with respect to the sections concerning deductions and what is to be included as income.

*By Stephen E. Strom.

(52)
The following two comments consist of explanations of the sections in the 1954 law applying to the topics named, especially with reference to changes in and amendments to the 1939 legislation.

The 1954 Code, by its own provisions, applies only with respect to taxable years beginning after December 31, 1953, and ending after the date of enactment of the Code (unless otherwise expressly stated in each particular section), thereby applying to the calendar year of 1954 and tax years thereafter. The effective date of each provision, unless otherwise expressly stated, is August 17, 1954.

INCOME UNDER THE 1954 INTERNAL REVENUE CODE

Section 61 of the Internal Revenue Code of 1954 states "Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

(1) Compensation for services, including fees, commissions, and similar items;
(2) Gross income derived from business;
(3) Gains derived from dealings in property;
(4) Interest;
(5) Rents;
(6) Royalties;
(7) Dividends:
(8) Alimony and separate maintenance payments;
(9) Annuities;
(10) Income from life insurance and endowment contracts;
(11) Pensions;
(12) Income from discharge of indebtedness;
(13) Distributive share of partnership gross income;
(14) Income in respect of a decedent; and
(15) Income from an interest in an estate or trust."

After defining adjusted gross and taxable income, the Code then contains seven sections dealing with items specifically included and twenty-one sections dealing with items specifically excluded from gross income. The more important of these inclusions and exclusions are discussed below.

ALIMONY AND SEPARATE MAINTENANCE PAYMENTS

The wife's gross income must include, under the 1954 Code, periodic alimony or separate maintenance payments made by the husband under a written separation agreement.

1. INTERNAL REVENUE CODE OF 1954, section 7851 (a) (1) (A).
2. INTERNAL REVENUE CODE OF 1954, section 7851 (a) (7).
agreement executed after the date of enactment of this bill, if they are living apart and do not file a joint return for the taxable year.¹

Under prior law, only periodic payments imposed by a court decree or by a written agreement incident to a decree were taxable to the wife.²

Such amounts taxable to the wife are allowable as a deduction to the payor if the amounts were includible in his gross income.³

**Annuities and Certain Proceeds of Endowment and Life Insurance Contracts**

A completely new method is set out in Section 72 of the 1954 Code for the taxation of annuity payments and the proceeds of endowment and life insurance contracts paid other than by reason of the death of the insured. Amounts received as an annuity, whether for a period certain or for one or more lives, under an annuity, endowment, or life insurance contract, must be included in gross income,⁴ except that the recipient may exclude that part of each payment which bears the same ratio to such payment as the investment in the contract bears to the expected return under the contract.⁵ Both the investment in the contract and the expected return under the contract are computed as of the annuity starting date, which is defined as the date payments are to start under the contract, or January 1, 1954, whichever is later.⁶ The investment in the contract is defined as the aggregate amount of premiums or other consideration paid, less the aggregate tax-free amounts received under the contract, as of the annuity starting date.⁷ The expected return⁸ is computed by multiplying the amount of each payment by the number of payments yet to be made as of the annuity starting date. This method will apply to either "life expectancy" or "period certain" annuities. A shorthand method of determining the excludable portion of each payment (in the case of ordinary non-increasing annuities) is to divide the investment in the contract by the number of payments to be made, as of the annuity starting date.

**Example 1:** Suppose A buys an annuity designed to provide payments of $100 per month for a period of 10 years. He pays $10,000 for the contract. His investment in the contract is $10,000, and his expected return under the contract is $12,000. The ratio of investment in the contract to expected return under the contract is therefore 5/6, and as the payments he receives annually amount to $1,200, the tax-free portion is 5/6 of $1,200, or $1,000.

**Example 2:** Suppose X buys an annuity designed to provide him with an income of $100 per month for life. His life expectancy as of the annuity

---

¹ 1954 Code Sec. 71(a) (2).
² 1939 Code, Sec. 22(k); 1954 Code, Sec. 71(a) (1).
³ 1954 Code, Sec. 215.
⁴ 1954 Code, Sec. 72(a); all references to section numbers hereafter will be those of the 1954 Code, unless otherwise specified.
⁵ Sec. 72(b).
⁶ Sec. 72(c) (4).
⁷ Sec. 72(c) (1).
⁸ Sec. 72(c) (3).
starting date is 20 years. The expected return under the contract is therefore $24,000. He paid $18,000 for the contract. The ratio of investment to expected return is then ¾. The tax-free portion of each year's $1,200 return is then ¾ of $1,200, or $900, no matter how long X lives. The remaining $300 annual return must be included in gross income.

Where a contract contains a refund feature, as for example a life annuity with a minimum period of payments certain, the investment in the contract must be reduced by the value of the refund, computed without discount for interest, as of the annuity starting date.9

Where, in the case of an employee’s annuity, the amounts payable in the first three years under the contract will equal or exceed the employee's contributions to the contract, all of such payments shall be excluded from the employee's gross income until he has recovered his contributions. Thereafter all payments are taxable in full.10

Amounts received under an annuity, endowment, or life insurance contract, and not paid as an annuity payment, (as for example, dividends) are includable in gross income if paid on or after the annuity starting date.11 If paid before the annuity starting date, such amounts are taxable only to the extent that, added to other tax free amounts received under the contract, they exceed the aggregate consideration paid for the contract.12 The preceding sentence also describes the tax treatment to be accorded amounts received after the annuity starting date, if received in full discharge of the contract, or upon the surrender, redemption or maturity of the contract.13 Where a lump sum payment is made, the tax on the portion which is includable in gross income is computed as though the payment had been received ratably over the taxable year and the two preceding taxable years.14

Where it is necessary15 to compute employee contributions to a contract, an employer's contributions may be included to the extent that they were taxable to the employee, or were amounts which if they had been paid directly to the employee at the time they were contributed, would not have been taxable to the employee.16

Another change in prior law is provided in Section 72 (h) to the effect that where an option to receive an annuity, in lieu of a lump sum in full discharge of a contract, is exercised within 60 days after the lump sum is payable, no part of such lump sum shall be included in gross income at the time such sum was payable.

9. Sec. 72(e) (2).
10. Sec. 72(d) (1).
11. Sec. 72 (e) (1) (A).
12. Sec. 72(e) (1) (B).
13. Sec. 72(e) (2) (A) and (B).
14. Sec. 72(e) (3).
15. For purposes of Sec. 72(e) (1) (A), 72(d) (1), and 72(e) (1) (B).
16. Sec. 72(f) (1) and (2).
Prizes and Awards

All amounts, with certain exceptions, received as prizes or awards must be included in gross income. This is a specific provision of Section 74 of the 1954 Code. Amounts excepted are those received primarily in recognition of religious, charitable, scientific, educational, artistic, literary, or civic achievement, provided that the recipient was selected for the prize or award without any action on his part toward winning, receiving, or obtaining such prize or award, and provided that the recipient is not required to render substantial future services in order to receive the prize or award.

Certain Death Benefits

Generally, amounts received under a life insurance contract, if payable by reason of the death of the insured, need not be included in gross income. Certain exceptions will be pointed out. A transferee for valuable consideration of a life insurance contract or any interest therein is entitled to exclude from gross income only as much of the proceeds as will not exceed the sum of the actual value of the consideration and the premiums and other amounts subsequently paid by the transferee. The foregoing provision does not apply, and complete exemption is granted to the transferee if there is a basis for determining gain or loss to the transferee by reference to the basis of the contract in the hands of the transferor, or if the contract or interest therein is transferred to a partner of the insured, or to the partnership in which he was a partner, or to a corporation in which he was a shareholder or officer.

Under the new Code, life insurance proceeds payable in installments are taxable as to the interest portion of the mixed principal-interest payment. However, if payments are to the surviving spouse of the insured, the first $1000 of such interest portion is tax free each year. The tax free portion of each installment can be computed by dividing the amount held by the insurer by the number of installments to be paid. The excess of each installment over this figure is taxable to the recipient, except in the case where an additional exemption is allowed a surviving spouse. A surviving spouse gets only one exclusion for each insured regardless of the number of policies.

The first $5,000 paid by reason of death to an employee's beneficiary or estate, by or on behalf of his employer or employers, need not be included in gross income. Only $5,000 may be excluded for any one employee.

17. Sec. 74(a).
18. Sec. 74(b) (1) & (2).
19. Sec. 101(a) (1).
20. Sec. 101(a) (2).
21. Sec. 101(a) (2) (A).
22. Sec. 101(a) (2) (B).
23. Sec. 101(d) (1).
24. Sec. 101(d) (1) (B).
25. Sec. 101(d) (1).
26. Sec. 101(d) (1) (B).
27. Sec. 101(b).
Compensation for Injuries or Sickness

Carrying forward prior law, gross income does not include amounts received as compensation for personal injuries or sickness, 1) under workmen's compensation acts, 2) through accident or health insurance, 3) as damages, and 4) as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country.

The 1954 Code changes prior law so that the exclusion under this section is inapplicable to amounts received by an employee through accident or health insurance to the extent that such amounts are attributable to contributions by the employer which were not included in the employee's gross income.

New exclusions from gross income under the 1954 Code are amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the Coast and Geodetic Survey or the Public Health Service.

Employer Contributions to Accident and Health Plans

Under Section 106 of the 1954 Code, contributions by the employer to accident or health plans for compensation, through insurance or otherwise, to his employees for personal injuries or sickness are not includable in the gross income of the employee.

This section is intended to change prior law in that this exclusion is allowed whether the plan covers a group of employees or one employee, and therefore premiums paid by an employer on an individual policy of accident or health insurance for an employee will not be included in the employee's gross income as such contributions were under prior law.

Amounts Received Under Accident and Health Plans

First of all, Section 105 of the new Code sets out the general rule that amounts received by an employee through accident or health insurance for personal injuries or sickness shall be included in the gross income of the employee to the extent that such amounts are attributable to contributions by the employer which were not included in the gross income of the employee. This section also applies to payments made by the employer, under non-insured plans as well as under insured plans.
The new section then excepts from the application of this general rule, and therefore excludes from the employee's gross income, amounts paid as reimbursement for medical expenses incurred by the employee, amounts paid for permanent loss or loss of use of a member or function of the body, or for permanent disfigurement, amounts paid without regard to the employee's absence from work and computed according to the nature of the injury, and amounts paid in lieu of wages up to $100 per week. It is difficult for this writer to perceive just what type of accident or health benefit would be taxable to the employee under this section.

In general, this section has the effect of excluding from income amounts paid for medical expense reimbursement, for personal injuries and in lieu of wages up to $100 per week, and of including in income amounts paid in lieu of wages above $100 per week.

**Income from Discharge of Indebtedness**

In certain specified cases the income that results when a taxpayer discharges a debt by payment of less than the full amount is not taxable as income under Section 108 of the 1954 Code. Under prior law only corporate indebtedness that was evidenced by a security was covered. Now the present section applies to any corporate indebtedness, whether evidenced by a security or not, and to debts of an individual incurred or assumed in connection with property used in his trade or business. The taxpayer must agree to reduce the basis of its assets by the amount so excluded from gross income. So it can be seen that at a later sale of its assets the taxpayer might have a taxable gain resulting from the reduction in basis here required, so that in the end some tax might have to be paid on the amount resulting from the discharge of a debt.

**Dividends**

The new Code provides that, effective for tax years ending after July 1954 the first $50 of dividends received by an individual need not be included in his gross income. All dividends in excess of $50 must be included in gross income, but effective as to dividends received after July 31, 1954, a credit against tax may be taken of 4 per cent of such dividends. However such credit may not exceed 2 per cent of taxable income for taxable years ending before January 1, 1955, and 4 per cent of taxable income for subsequent taxable years.

39. Sec. 105(b).
40. Sec. 105(c)(1).
41. Sec. 105(c)(1).
42. Sec. 105(c)(2).
43. Sec. 105(d).
44. 1939 Code, Sec. 22(b)(9).
45. Sec. 108(a)(1)(A).
46. Sec. 108(a)(1)(B).
47. Sec. 108(a)(2); see also Sec. 1017.
48. Sec. 116(a).
49. Sec. 34(a).
50. Sec. 34(b)(2)(A).
51. Sec. 34(a)(2)(B).
If husband and wife, filing a joint return, each have dividend income of $50 or more, the exclusion is $100. If only one has dividend income, the exclusion is $50.

The dividend exclusion and credit provisions do not apply to dividends received from certain insurance companies, foreign corporations, corporations organized under the China Trade Act of 1922, certain charitable corporations, farmer’s cooperative associations, corporations deriving most of their income from United States possessions, certain mutual savings banks, and certain regulated investment companies.

Also the exclusion and credit provisions do not apply to certain nonresident aliens.

Scholarship and Fellowship Grants

The taxability of amounts received as scholarship and fellowship grants may be determined by reference to Section 117 of the new Code. This section had no counterpart in the 1939 Code. The general rule is that the recipient may exclude from his gross income amounts received as a scholarship or a fellowship grant. This exclusion includes the value of contributed services and accommodations, and in so far as they are incident to the grant and actually expended by the recipient, amounts received for travel, research, clerical help or equipment.

Some limitations are put upon the amount which the recipient may exclude from gross income. Individuals who are candidates for degrees may not exclude amounts received in so far as they represent payment for teaching, research, or other services in the nature of part time employment required as a condition to receiving the grant. However if such teaching, research, or other services are required of all candidates for the degree as a condition of receiving the degree, this limitation is inapplicable.

In the case of individuals who are not candidates for degrees, the exclusion is allowed only if the grant is from certain institutions, and then only to the extent of $300 per month for a maximum period of 36 months.

52. Sec. 116(b) (1).
53. Sec. 116 (a).
54. Sec. 116(b) (2).
55. Sec. 116(b) (3) (A); see also Sec. 501.
56. Sec. 116(b) (3) (A); see also Sec. 521.
57. Sec. 116(b) (3) (B); see also Sec. 931.
58. Sec. 116(c) (1); see also Sec. 591.
59. Sec. 116(c) (2); see also Sec. 851.
60. Sec. 116(d); see also Sec. 871.
61. Sec. 117(a) (1) (A) and (B).
62. Sec. 117 (a) (2).
63. Sec. 117 (b) (1).
64. Sec. 117 (b) (1).
65. Sec. 117(b) (2) (A).
66. Sec. 117(b) (2) (B).
MISSOURI LAW REVIEW

MEALS OR LODGING FURNISHED FOR THE
CONVENIENCE OF THE EMPLOYER

If furnished primarily for the convenience of the employer, the value of meals furnished to an employee on the employer's business premises need not be included in the gross income of the employee. If an employee must accept lodging on the business premises of the employer as a condition of his employment, the value of such lodging need not be included in the employee's gross income. Section 119 further provides that provisions of an employment contract or of a State statute fixing terms of employment shall not be determinative of whether meals and lodging are furnished for the convenience of the employer or are intended as compensation.

STATUTORY SUBSISTENCE ALLOWANCES RECEIVED BY POLICE

Where statutes provide for subsistence allowances for police officials of a State, Territory, United States possession, or of any political subdivision of the foregoing, or of the District of Columbia, such allowances are not taxable, except to the extent that they exceed $5 per day. To the extent that such allowances are excluded from gross income, no deduction will be allowed for the expenses for which the allowance was paid. However such expenses are deductible to the extent they exceed the amount excluded under the section, that is $5 per day.

THOMAS D. DWYER

INDIVIDUAL DEDUCTIONS UNDER THE
1954 INTERNAL REVENUE CODE

This discussion concerns only such of those deductions provided under the new code as apply to the individual taxpayer, as distinguished chiefly from the corporate body. However, the mere fact of their inclusion here is not intended to indicate non-application to corporations or other forms of business organization.

THE STANDARD DEDUCTION

Individual taxpayers may elect to take a standard deduction in lieu of other itemized deductions and certain credits. Under the 1954 Code, the standard deduction is 10 per cent of the adjusted gross income or $1,000, whichever is smaller, except that it may not exceed $500 in the case of a separate return by a married person.

67. Sec. 119(1).
68. Sec. 119(2).
69. Sec. 120(a).
70. Sec. 120(b) (1).
71. Sec. 120(b) (2).
72. Sec. 120(b) (2).

1. INTERNAL REVENUE CODE OF 1954, section 141. Hereinafter, the 1954 Code will be cited as "1954, Sec. 0000," and the INTERNAL REVENUE CODE OF 1939 as "1939, Sec. 0000."
Although the 1939 act\textsuperscript{2} is worded differently and requires a determination of whether or not the adjusted gross income is over or under $5,000, the net effect of the new act is to retain the prior provision.

All persons are not eligible to take the standard deduction. One spouse is not allowed the option unless the other does likewise.\textsuperscript{3} Others ineligible\textsuperscript{4} are: non-resident aliens,\textsuperscript{5} citizens of the United States entitled to the benefits of Section 931 relating to income from sources within the possessions of the United States,\textsuperscript{6} persons making returns under Section 443(a) (1) for a period less than twelve months due to changes in their annual accounting period,\textsuperscript{7} estates or trusts,\textsuperscript{8} common trust funds,\textsuperscript{9} or partnerships.\textsuperscript{10} The determination as to marriage is made at the end of the tax year, or at the earlier date of the spouse's death, with legal separation not being considered marriage.\textsuperscript{11}

No changes have been made with respect to the method of election or change of election to take the standard deduction. If the adjusted gross income is less than $5,000, the election to take the standard deduction is considered made if the taxpayer elects to pay the tax set out in Section 3,\textsuperscript{12} but if the amount above stated is more than $5,000, the deduction may be taken if the taxpayer so elects on his return.\textsuperscript{13} Failure to elect to take the deduction will amount to an election not to take it.\textsuperscript{14} Where the taxpayer improperly figures the amount of his adjusted gross income, his original choice to take or not to take the deduction stands.\textsuperscript{15} A change of election may be made after the filing of the return for the particular year.\textsuperscript{16}

Certain credits against the tax are not allowed in the case of individuals electing to take the standard deduction.\textsuperscript{17} These include foreign corporation\textsuperscript{18} and tax-free covenant bonds,\textsuperscript{19} taxes of foreign countries and possessions of the United States,\textsuperscript{20} and partially tax-exempt interest received by individuals from obligations of the United States and government corporations.\textsuperscript{21} The 1939 Code \textsuperscript{22} also excluded all

\begin{itemize}
  \item 2. 1939, Sec. 23(aa) (1) (A) and (B).
  \item 3. 1934, Sec. 142(a); 1939, Sec. 23 (aa) (4).
  \item 4. 1934, Sec. 142(b).
  \item 5. 1939, Sec. 213(d).
  \item 6. 1939, Sec. 251(e) (1).
  \item 7. 1939, Sec. 23(aa) (5).
  \item 8. 1939, Sec. 162(f).
  \item 9. 1939, Sec. 169(d) (4).
  \item 10. 1939, Sec. 185(d).
  \item 11. 1934, Sec. 143; 1939, Sec. 23(aa) (6).
  \item 12. 1934, Sec. 144(a) (2); 1939, Sec. 23(aa) (3) (B).
  \item 13. 1934, Sec. 144(a) (1); 1939, Sec. 23(aa) (3) (A).
  \item 14. 1934, Sec. 144(a) (3); 1939, Sec. 23 (aa) (3) (D).
  \item 15. 1934, Sec. 144 (a) (1) and (2); 1939, Sec. 23(aa) (3) (D).
  \item 16. 1934, Sec. 144(b); 1939, Sec. 23(aa) (7). Special requirements are set out in these sections in the case where the taxpayer and his spouse file separate returns and desire to change their election.
  \item 17. 1954, Sec. 36; 1939, Sec. 23(aa) (2).
  \item 18. 1954, Sec. 32; 1939, Sec. 32.
  \item 19. 1954, Sec. 32; 1939, Sec. 23(aa) (2) (C).
  \item 20. 1954, Sec. 33; 1939, Sec. 23(aa) (2) (B).
  \item 21. 1954, Sec. 35; 1939, Sec. 23(aa) (2) (D).
  \item 22. 1939, Sec. 23(aa) (2) (A).
\end{itemize}
other deductions, except those set out in one particular section.23 The new Code would seem to permit any credit or deduction to be taken unless expressly forbidden, while the old law denied all except those expressly permitted. However, "taxable income" in the new act is computed, in the case where the standard deduction is taken, by subtracting only such standard deduction and the deductions for personal exemptions provided in Section 151 from the adjusted gross income,24 thereby achieving the same result.

ALLOWANCE OF DEDUCTIONS FOR PERSONAL EXEMPTIONS

Under the 1954 Code, personal exemptions are allowed as deductions in computing taxable income,25 while under the old law such allowances were made as credits against net income.26

The basic allowances have not been changed. The taxpayer may take an exemption of $600, and an additional $600 for his spouse if the taxpayer makes a separate return and the spouse has no gross income nor is the dependent of another taxpayer.27 An additional $600 is allowed if the taxpayer or his spouse is blind, or $1,200 should they both be blind.28 The same provision is made where the taxpayer or his spouse or both is 65 years of age or over.29

An additional exemption of $600 is allowed for each dependent whose gross income, during the calendar year in which the taxpayer's tax year begins, is less than $600.30

The 1954 Code makes an addition to the old law with respect to deductions allowed for dependents.31 Under this provision, the $600 deduction is permitted even if the dependent does earn $600 during the year, provided the dependent is a child of the taxpayer and under 19 years of age (at the close of the calendar year in which the taxpayer's tax year begins) or a student. "Child" is defined as a dependent son, stepson, daughter, or stepdaughter.32 A "student" is defined as one who, during five months in the calendar year in which the taxpayer's tax year begins, is a full time student at an educational institution or a full time on-the-farm trainee under state or educational institution supervision.33 An "educa-

23. 1939, Sec. 22(n). Includes trade and business expenses, expenses of travel and lodging in connection with employment, reimbursed expenses in connection with employment, deductions attributable to rents and royalties, certain deductions of life tenants and income beneficiaries, losses from the sale or exchange of property, and long-term capital gains.

24. 1954, Sec. 69(b). In the 1939 act, personal exemptions were not considered as deductions.

25. 1954, Sec. 151(a).
26. 1939, Sec. 25(b) (1).
27. 1954, Sec. 151(b); 1939, Sec. 25(b) (1) (A).
28. 1954, Sec. 151(d); 1939, Sec. 25(b) (1) (C).
29. 1954, Sec. 151(e); 1939, Sec. 25(b) (1) (B).
30. 1954, Sec. 151(e) (1) (A); 1939, Sec. 25(b) (1) (D).
31. 1954, Sec. 151(e) (1) (B).
32. 1954, Sec. 151(e) (3).
33. 1954, Sec. 151(e) (4) (A).
tion institution” must be one which maintains a regular faculty, curriculum, and organized body of students at the place where the educational activities are carried on, thereby excluding correspondence schools, etc. In order to qualify for this deduction, the child or student must still meet the definition of “dependent” as provided by section 152. The net effect of the two provisions is that the child who is under nineteen or a student may be claimed as a deduction, regardless of the amount he earns, subject only to the limitation that he earn not more than half the amount used for his support, whether he actually spends his earnings on his own support or not.

A question arises as to whether or not a student or child under 19 making over $600 in a year, for whom his parent may take a deduction under the new sections discussed above, may also take his own personal exemption deduction when he files a tax return on his earnings for the year. The Code seemingly makes no reference to the problem. To permit the dependent to take the allowance would affect a double deduction, one taken by himself and one by his parent. On the other hand, to deny the double allowance would have the effect of nullifying the new provision, for while the parent would be allowed to deduct $600 from his income, the student would be required to pay tax on his entire earnings. The latter interpretation would have the singular advantage of taxing the $600 at a lower rate, as ordinarily the parent's income will be in a higher bracket than that of the student dependent. Section 151(e)(2), providing that no exemption is allowed for a dependent who is married and makes a joint return with his spouse, may shed light upon the question, but in two opposing directions: the inclusion of this single exception to the exemptions may impliedly exclude all others, thus permitting the double allowance, while on the other hand, the exception shows an intention to deny double exemptions. The reports of the legislative committee give no inkling to the solution. However, the evident purpose of the new section, to permit a deduction for education expenses, would seem to force a decision that the allowance may be taken by both parties.

No exemption may be made for any dependent who has made a joint return with his spouse in the calendar year in which the tax year of the taxpayer begins.

The definition of "dependent" includes only those persons who receive over one half of their support from the taxpayer during the calendar year in which the taxpayer's tax year begins and who are related to the taxpayer in the manner set forth in Section 152(a)(1) through (8). These relatives are children or their descendants, step children, brothers and sisters (both full and half blood) and their children, parents of their ancestors, step parents, aunts and uncles, and in-law children or parents or brothers or sisters. In addition, the 1954 Code includes one receiving the support minimum who, during the tax year of the taxpayer, has his

34. 1954, Sec. 151(e) (4).
35. 1955, Sec. 25(b) (3). Note the special provision in 1954, Sec. 152(d).
36. 1954, Sec. 151(e) (2); 1939, Sec. 25(b) (1) (D).
37. 1954, Sec. 152(a); 1939, Sec. 25(b) (3).
38. 1959, Sec. 25(b) (3) (A) through (H).
principle home or place of abode at the home of the taxpayer and is a member of his household. This permits the taxpayer to claim such persons as a child not legally adopted. The new Code also includes a cousin receiving institutional care during the tax year of the taxpayer, required due to mental disability, and who was previously a member of the taxpayer's household, provided the support requirements are still met.

An adopted child is treated as a child of the blood in both Codes, but the 1954 edition omits Section 25(b)(3) of the 1939 law which included as a "child" one for whom an adoption petition was filed but denied due to the mental incapacity of the surviving natural parent to agree. The revised law expressly omits from the term "dependent" non-citizens of the United States, unless they be residents of this country, a country contiguous to the United States, the Canal Zone, or the Republic of Panama, the 1939 law not containing the last two exceptions. The disqualification applies only to non-citizens, therefore having no application to a person who is a citizen of two countries. By its terms, the new section does not apply to certain Phillipine-born children.

A payment to a wife which is includible in her gross income under Section 71 (relating to alimony and separate maintenance payments) or 682 (relating to the income of an estate or trust in case of a divorce) is not treated as a support payment.

The 1939 law caused inequities in the situation where more than one person contributed to the support of an individual, but where none provided more than the one-half necessary in order to obtain the deduction. The new revenue code provides that a taxpayer may be considered as having provided more than one half the support of an individual if no one person contributed over half, if over half was received from persons each of whom would have been able to claim the individual as a dependent were it not for the percentage requirements, if the taxpayer contributed over ten per cent of such support, and if all other persons contributing more than ten per cent of the support file a written declaration that they will not claim the individual as a dependent. This new rule permits the persons providing the support to "pass around" the deduction from year to year. The individual himself might well be one of those contributing to his own support.

A special support test is provided for the taxpayer's children or step children who are students. Section 152(d) of the 1954 Code provides that amounts received as scholarships for study at an educational institution are not to be taken into account in determining whether the student received more than half his support from the taxpayer.

39. 1954, Sec. 122(a) (9).
40. 1954, Sec. 152(a) (10).
41. 1954, Sec. 125(b) (2); 1939 Sec. 52 (b) (3).
42. 1954, Sec. 152(b) (3).
43. 1939, Sec. 25(b) (3).
44. 1954, Sec. 152(b) (4); 1939, Sec. 25(b) (3).
45. 1954, Sec. 152(c).
For the purposes of ascertaining the personal exemption deductions, marital status is determined as of the close of the tax year, or at the earlier date of the death of the spouse. Legal separation under divorce or separate maintenance is not considered marriage.46

An important addition has been made in the 1954 Code relative to joint returns. The new law retains the provisions for the filing of joint returns of a husband and wife, such being provided for in Section 6013, corresponding roughly to Sections 51(b) and (g) of the 1939 Code. This allows the taxpayer, in most cases, to be taxed at a lower rate, as his taxable income is cut in half (thus placing that portion in a lower tax bracket) and the tax thereon doubled. In making such joint return, a person may take the personal exemption of his spouse even though the spouse died during the tax year, as the determination as to one's marital status is made at the end of the year or at the earlier death of the spouse. Section 2(a) of the new law says a return of a surviving spouse may be treated as a joint return. A "surviving spouse", under Section 2(b) (1), includes a taxpayer whose spouse died during either of the two taxable years preceding the present year and who maintains as his home a household which is the main place of abode for children or step-children for whom he is entitled to a Section 151 deduction, provided he has not remarried. These sections allow a taxpayer, whose spouse died in 1952, to file a joint return in the year of the death, in 1953 (had the provision been applicable at that time), and in 1954, thus taking advantage of the lower tax in each year. The 1939 Code, in corresponding Section 12(d), did not allow such filing in the last two years mentioned. However, under the new sections, no provision is made for the taxpayer to claim a personal exemption of $600 for the deceased spouse in the two latter years, even though he is filing a joint return therein.

**ITEMIZED DEDUCTIONS FOR INDIVIDUALS**

Sections 161 through 175 provide for deductions in computing taxable income, corresponding with the provisions of Section 23 in the 1939 Internal Revenue Code.

**Trade or Business Expenses**

Both Codes provide as a deduction all the ordinary and necessary expenses paid or incurred during the tax year in carrying on any trade or business, including salaries, traveling expenses (which covers meals and lodging), and rentals.47 The new act limits the deduction for living expenses of a member of Congress to $3000. The 1939 provisions48 concerning the expenses of the National American Red Cross sports program have been omitted. The present Code adds Section 162(b), which is essentially the same as Section 23(a) (1) (B) of the former law, but now applies it to individuals as well as corporations. This section provides that no deduction shall be allowed under the business expenses section for any contribution or gift which

46. 1954, Sec. 153; 1939, Sec. 25(b) (2).
47. 1954, Sec. 162; 1939, Sec. 23(a).
48. 1939, Sec. 23(a) (1) (A).
would be allowable as a deduction under Section 170 (relating to charitable gifts and contributions, etc.) were it not for the limitations imposed therein on such gifts. Note that the section does not apply to transfers with consideration. New rules also have been enacted applying to expenses in connection with subdividing real property for sale.

Interest

All interest paid or accrued during the tax year may be taken as a deduction. The new Code provides special rules for installment purchases where the interest charge is not stated separately. If personal property is purchased under a contract providing for installment payments and stating carrying charges separately, but where the interest charge cannot be ascertained, then the payments so made are treated as though six per cent of the average unpaid balance, on the first of each month during the year, was interest, limited, however, to the amount of the aggregate carrying charges attributed to the particular year. The section does not apply to business expenses or to definitely ascertainable interest charges.

Reference must be made to Sections 264, 265(2), 266, and 267, with respect to interest deductions, as certain disallowances are made therein. These will be discussed later in this article.

Taxes

Taxes paid or accrued during the taxable year are deductible. However, no such allowance is made for certain named taxes.

Both Codes exclude federal income taxes with the new law including as "income taxes" those imposed under Section 3101 relating to the tax on employees under the Federal Insurance Contributions Act, the taxes imposed by Sections 3201 and 3211 relating to taxes on railroad employees and their representatives, and the tax withheld at the source on wages in Section 3402 relating to withholding taxes on employees. The 1954 revision retains the old provisions by also excluding federal war profits and excess profits taxes, federal import duties and federal excise and stamp taxes (which does not, however, exclude their deduction as business or trade expenses), estate, inheritance, legacy, succession, or gift taxes, or income, war profits and excess profits taxes imposed by foreign countries or United States possessions (if the taxpayer chooses to take credit for them under Section 901). Both laws exclude taxes assessed against local benefits of a kind tending to increase the value of the property assessed, but not so much of such taxes as are

49. 1954, Sec. 1237.
50. 1954, Sec. 163(a); 1939, Sec. 23(b).
51. 1954, Sec. 163(b).
52. 1954, Sec. 164(a); 1939, Sec. 23(c) (1).
53. 1954, Sec. 164(b) (1); 1939, Sec. 23(c) (1) (A).
54. 1954, Sec. 164(b) (2); 1939, Sec. 23(c) (1) (B).
55. 1954, Sec. 164(b) (3); 1939, Sec. 23(c) (1) (F).
56. 1954, Sec. 164(b) (4); 1939, Sec. 23(c) (1) (D).
57. 1954, Sec. 164(b) (6); 1939, Sec. 23(c) (1) (C).
allocable to maintenance or interests costs.\(^58\) The new law adds that the section shall not prevent deduction of taxes levied by a special taxing district if such district covers at least an entire county with a minimum of 1000 persons subject to the tax, such assessments being levied annually at a uniform rate on the same valuation as used for real property taxes generally. The 1954 Code, Section 164(b)(7), also excludes taxes paid on real property to the extent that Section 164(d) requires them to be treated as imposed on another taxpayer. This aspect will be discussed later.

Subject only to a rewording in the present revision, the old rules permitting the deduction of any state or local sales tax stand.\(^59\) "Sales tax" is defined therein as a tax imposed by a political subdivision on persons selling personal property at retail (or gasoline at wholesale or retail), being a stated sum per unit or measured by the gross sales price, or imposed on persons who furnish services at retail.

A new section, 164(d), has been added to the 1954 Code, relating to the apportionment of taxes on real property as between the seller and purchaser. As to current taxes on realty, the section treats the purchaser as the person taxable for the portion of the real property tax year beginning on the date of the closing of the sale, while the seller is considered liable for the period preceding that date. The parties must claim their deductions in this manner regardless of the fact that they actually did not apportion the tax, per Section 164(b)(7) mentioned earlier. If the taxpayer cannot deduct an amount for taxes until he has paid them, by reason of his chosen system of accounting (cash receipts and disbursements method), he may still claim these amounts if the other party to the transaction is liable for the taxes rather than the taxpayer, due to the provisions of the particular real property tax law. If neither party is liable for the property tax, due to such laws, then the party holding the property at the time the tax becomes a lien on the property is considered liable for the tax for the property tax year.

If the taxpayer's income is computed under the accrual method of accounting, and no election is made under Section 461(c) to apply a real property tax ratably over the period to which such tax applies, then the portion of tax treated as applying to the taxpayer under the normal rules explained in the preceding paragraph, which cannot be deducted in any one tax year due to the accounting system used, is treated as having accrued on the date of the sale.

The new section applies to tax years ending after December 31, 1953, but only in the case of a sale made after that date. Nor does it apply to real property taxes deductible under the 1939 law to the seller for tax years ending before January 1, 1954, meaning that if the particular tax was an allowable deduction under the prior Code, the section does not apply. The new rules do not affect delinquent taxes, which are still treated as part of the purchase price of the land.

The rules as to taxes of a shareholder paid by his corporation have not been

---

58. 1954, Sec. 164(b)(5); 1939, Sec. 23(c)(1)(E).
59. 1954, Sec. 164(c); 1939, 23(c)(3).
changed, and where the shareholder does not reimburse the corporations for such payments, the latter takes the deduction rather than the former.

Under Section 1451(f), relating to tax-free covenant bonds, the obligor is not allowed a deduction for the payment of miscellaneous excise taxes or tax paid pursuant to the tax-free covenant clause.61

Losses

Certain losses sustained by an individual during the taxable year, which are not compensated for by insurance or otherwise, are deductible.62 The basis for determining the amount of a loss is the adjusted basis provided for in Section 1011,63 which states that the basis is to be calculated according to particular sections cited therein. The deduction is limited to losses incurred in a trade or business, in any transaction entered into for profit, and losses from fire, storm, shipwreck, theft or other casualty.64 Wagering losses are allowed only to the extent of gains.65 Theft losses are considered as sustained in the tax year in which they are discovered.66 Losses from dispositions of capital assets are allowed only to the extent of the gains, plus the taxable income of the taxpayer or $1000, whichever is smaller (income being computed without regard to personal exemption deductions).67

Included as a loss from the disposition of a capital asset is any capital asset security which becomes worthless during the taxable year.68 "Security" is defined as stock in a corporation, a right to subscribe for or receive such stock, or a bond, debenture, note, certificate, or other evidence of indebtedness issued by a corporation or political subdivision, having interest coupons or being in registered form.69 The 1939 Code included only the first two mentioned. No deduction is allowed for the worthlessness of any debt owned by a political party.70

Bad Debts

Any debt which becomes worthless during the tax year may be counted as a deduction. If a debt is recoverable in part, the worthless portion may be deducted.71 The basis for determining the amount of loss from a bad debt is the same as used in

60. 1954, Sec. 164(e); 1939, Sec. 23(d).
61. 1954, Sec. 1451(f); 1939, Sec. 143(a)(3).
62. 1954, Sec. 165(a); 1939, Sec. 23(e).
63. 1954, Sec. 165(b); 1939, Sec. 23 (1).
64. 1954, Sec. 165(a); 1939, Sec. 23(e).
65. 1954, Sec. 165(d); 1939, Sec. 23(h).
66. 1954, Sec. 165(e). No such section exists in the 1939 Code, but Regulation 118, Sec. 39.43-2 did provide the same, but treated the loss as sustained in the year it occurred, rather than when discovered.
67. 1954, Sec. 165(f); 1939, Sec. 23(g)(1).
68. 1954, Sec. 165(g)(1); 1939, Sec. 23(g)(2).
69. 1954, Sec. 165(g)(2); 1939, Sec. 23(g)(3).
70. 1954, Sec. 271; 1939, Sec. 23(k)(6).
71. 1954, Sec. 166(a); 1939, Sec. 23(k)(1).
calculating the extent of a loss under Section 165.\textsuperscript{72} A deduction for a reasonable addition to a reserve for bad debts may be taken instead of the ordinary allowance.\textsuperscript{73}

Non-business bad debts continue to be treated as short term capital losses and not deductible under the bad debts sections.\textsuperscript{74} The 1954 Code defines “non-business debts” as those other than a debt created or acquired in connection with the taxpayer’s trade or business or a loss which is incurred in such trade or business from the worthlessness of a debt.\textsuperscript{75} The 1939 law permitted only the latter loss to be deducted as a bad debt, while the revision permits both to be so allowed.

The new Code does not permit the application of this section to debts evidenced by a bond, debenture, note, certificate, or other evidence of indebtedness, issued by a corporation or governmental subdivision, with interest coupons or in registered form.\textsuperscript{76} These debts are presently treated as securities under Section 165 (losses). The old law reached the same result, although the provision appeared in the bad debt section.\textsuperscript{77}

The taxpayer may treat as a debt becoming worthless any payment he makes in discharge of his obligation as a guarantor, endorser, or indemnitor of a noncorporate obligation the proceeds of which were used in the trade or business of the borrower, provided the obligation was worthless at the time of the payment.\textsuperscript{78} The 1939 law did not contain this provision.

As in case of losses, no deduction is allowed for the worthlessness of any debt owed by a political party.

\textbf{Depreciation}

A reasonable allowance for the exhaustion and wear and tear (including a reasonable allowance for obsolescence) of property used in the trade or business of the taxpayer, or held for the production of income, is allowed as a depreciation deduction.\textsuperscript{79}

The new Code has added several new provisions with respect to this deduction. Section 167 (b) sets up the methods under which the “reasonable allowance” may be determined (the straight line, declining balance, sum of the years-digits, or any other consistent method), subject to certain detailed limitations stated in sub-section (c) on the latter three. The taxpayer may make an agreement concerning the useful life and rate of depreciation of any property with the Secretary of the Treasury or his delegate, and both will be bound in the absence of facts or circumstances not cons-

\textsuperscript{72} 1954, Sec. 166(b); 1939, Sec. 23(i).
\textsuperscript{73} 1954, Sec. 166(e); 1939, Sec. 23(k)(1).
\textsuperscript{74} 1954, Sec. 166(d); 1939, Sec. 23(k)(4).
\textsuperscript{75} 1954, Sec. 168(d)(2); 1939, Sec. 23(k)(4).
\textsuperscript{76} 1954, Sec. 166(e).
\textsuperscript{77} 1939, Sec. 23(k)(2).
\textsuperscript{78} 1954, Sec. 166(f).
\textsuperscript{79} 1954, Sec. 167(a); 1939, Sec. 23(1).
sidered in making the agreement.\textsuperscript{80} Without such an agreement, the taxpayer may elect to change his method of depreciation from the declining balance to the straight line method.\textsuperscript{81}

The three suggested methods of figuring depreciation may be explained as follows:

Under the straight line method, the cost of the asset is divided by the useful life in years. This constant amount is then depreciated each year.

Under the declining balance method, a percentage rate is determined in the same manner as in the straight line method, then doubled. The amount depreciated each year is such double rate applied to the remaining value of the asset after the amounts depreciated in prior years have been subtracted, that is, the double rate applied to the unrecovered cost. As will be seen, under this method, the cost of the asset is never fully recovered.

Under the sum of the years-digits method, the sum of useful years remaining after each year of life is totaled. The depreciation rate is a fraction, the numerator of which is the useful life of the asset remaining at the beginning of each year, and the denominator is the sum of the years of life at acquisition, determined as stated.

A table showing a comparison of these methods is included in the footnotes.\textsuperscript{82}

Both Codes require that the basis for determining wear and tear, etc., of property is to be computed under the same provisions as used in calculating the extent of a loss under previous sections.\textsuperscript{83}

A life tenant may compute and deduct depreciation as though he were the absolute owner, but in the case of property held in trust, the deduction is apportioned between the income beneficiaries and the trustee according to the pertinent provisions of the trust.\textsuperscript{84} However, the 1954 law adds a provision to those just stated, and

\begin{table}[h]
\centering
\begin{tabular}{|c|c|c|c|}
\hline
Year & Straight Line & Annual Depreciation & Sum of Years-Digits \\
\hline
1 & $10,000 & $20,000 & $16,667 \\
2 & 10,000 & 12,000 & 13,333 \\
3 & 10,000 & 7,200 & 10,000 \\
4 & 10,000 & 4,320 & 6,667 \\
5 & 10,000 & 2,592 & 3,333 \\
\hline
Amound Recovered & $50,000 & $46,112 & $50,000 \\
\hline
\end{tabular}
\caption{Comparison of Depreciation Methods}
\end{table}

\begin{itemize}
\item \textsuperscript{80} 1954, Sec. 167(d).
\item \textsuperscript{81} 1954, Sec. 167(e).
\item \textsuperscript{82} This comparison is based upon a $50,000 asset with an estimated useful life of 5 years.
\item \textsuperscript{83} \textsuperscript{83} 1954, Sec. 167(f); 1939, Sec. 114(a).
\item \textsuperscript{84} 1954, Sec. 167(g); 1939, Sec. 23(1).
\end{itemize}
requires that in the case of an estate, the deduction is to be divided between the estate and the heirs, legatees, and devisees on the basis of the estate's income allotted to each.

Special rules are provided for in the case of deductions for depletion of mines, oil and gas wells, natural deposits and timber.85

Amortization of Emergency Facilities

Section 168 of the Internal Revenue Code of 1954, relating to amortization of emergency facilities, contains no substantive change from Section 124A of the 1939 law. The rules refer to amortization deductions of facilities erected or acquired in the interest of national defense in time of emergency. Therefore, its application being chiefly to a corporate taxpayer, discussion will be omitted here.

Amortization of Grain-Storage Facilities

Any taxpayer who constructs a grain storage facility may elect to take a deduction, in lieu of depreciation over its normal life, with respect to the amortization of the adjusted basis of the facility based on a 60-month period.86 A transferee of such a facility which had been so amortized by the transferor may elect to continue the method for the remainder of the period.87 The deduction is calculated by dividing the adjusted basis of the facility at the end of each month in the tax year by the number of months remaining in the 60 month period, and adding such amounts.88 An election to terminate the amortization deduction may be made at any time, subject to stated conditions.89

The definition of "grain-storage facility" means a structure primarily suitable for grain storage and intended by the taxpayer to be so used at the time of his election, provided its construction (or alteration from another use is completed between December 31, 1952, and December 31, 1956.90

The special adjusted basis of a facility of an original or subsequent owner is computed according to the method set forth in detail in Section 169(e). If the adjusted basis for the facility exceeds the basis as determined under the section just mentioned, a depreciation deduction may be taken for the excess.91

As in the case of depreciation, a life tenant is considered the absolute owner of the facility.92

The 1954 Code sections concerning amortization of storage facilities present no substantive change from Section 124B of the prior law.

85. 1954, Sec. 611; 1939, Sec. 23(m).
86. 1954, Sec. 169(a)(1).
87. 1954, Sec. 169(a)(2).
88. 1954, Sec. 169(a)(3).
89. 1954, Sec. 169(c).
90. 1954, Sec. 169(d).
91. 1954, Sec. 169(f).
92. 1954, Sec. 169(g).
A deduction may be taken for any charitable contribution made within the taxable year, subject, of course, to percentage limitations, etc., to be discussed.93

The 1954 edition of the Code retains the old rule in that the allowance is limited to 20 per cent of the adjusted gross income.94 However, a new provision96 states that such percentage is to be computed without regard to any charitable contributions made to a church or association of churches, educational organizations (other than correspondence schools, etc.) or hospitals, which do not exceed ten per cent of the taxpayer's adjusted gross income. Any gifts in excess of the amount deductible under the latter section may be included in the former. The net effect is to permit a taxpayer to take 30 per cent of his adjusted gross income as a deduction, provided he directs at least ten per cent of his gifts to the groups specifically named above.

The 20 per cent limitation does not apply to an individual whose charitable contributions plus income tax paid in the particular tax year and 8 out of the 10 preceding tax years, have exceeded his taxable income for such years, computed without regard to these sections, deductions for personal exemptions, or net operating loss carrybacks.96 The 1939 provision97 differed in that the preceding years must have included all of the prior ten years, and added war profits and excess profits taxes to the present allowance of gifts plus income taxes in determining the 90 per cent.

The new Code states that there is to be no deduction for gifts to a trust made after March 9, 1954, if the grantor has a reversionary interest in the corpus or income of that part of the trust which would ordinarily be deductible, nor if, at the time of the transfer, the value of a reversionary interest in the grantor exceeds five per cent of the value of the property.98 A reversionary interest includes any power exercisable by the grantor or a nonadverse party to revest the property or its income in the grantor.

Adjusted gross income, for the purpose of these sections, is computed without regard to any net operating loss carry back to the particular tax year.99

"Charitable contribution" is expressly defined.100 It includes a gift to or in trust for the United States or any political subdivision, if made for public purposes exclusively. Also, a gift to or in trust for a corporation, trust, or community chest, etc., created in the United States or any of its possessions, and organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes or for the prevention of cruelty to children or animals, provided that no earnings of the organization go to private persons, nor that the activities of the group consist in

93. 1954, Sec. 170(a); 1939, Sec. 23(o).
94. 1954, Sec. 170(b) (1) (B); 1939, Sec. 23(o).
95. 1954, Sec. 170(b)(1)(A).
96. 1954, Sec. 170(b)(1)(C).
97. 1939, Sec. 120.
98. 1954, Sec. 170(b)(1)(D).
99. 1954, Sec. 170(b).
100. 1954, Sec. 170(c); 1939, Sec. 23(o).
any part of carrying on propaganda or otherwise attempting to influence legislation. Likewise included is a gift to or in trust for an organization of veterans or their auxiliary units or trust or foundation for such organizations, provided the group is organized in the United States or its possessions and no profits thereof inure to private individuals. The 1939 law omitted the provision that the last named gifts may be made in trust. An individual may also make a deductible gift to or in trust for a domestic fraternal society, order, or association, operating under the lodge system, but only if the gift is to be used for the same purposes required in the case of a gift to a corporation, trust, or community chest. The 1954 Code adds to the definition of charitable contribution any gift to or in trust for a cemetery company owned and operated for the sole benefit of its members, or to any corporation chartered solely as a cemetery corporation, provided that neither is operated for profit and that none of the earnings go to private persons.

The new Code omits Section 23(o)(2) of the 1939 edition, which permitted the deduction of a contribution to the "special fund for vocational rehabilitation" for certain veterans, as such fund is no longer in existence. Also omitted is Section 23(o)(6), which permitted gifts to the United Nations to be deductible, due to the expiration of the section by its own terms in 1947.

It is important to note that the gifts permissible under the new ten per cent rule do not allow a gift in trust for such organizations to be so deducted, except, of course, under the ordinary 20 per cent provisions.

In certain other specified cases, the charitable gift deduction is disallowed. Section 503(e) provides that if the particular donee corporation or community chest, etc., is not exempt from taxation under Section 501, then no deduction will be permitted. Section 3813(e) of the old law provided substantially the same. Section 11(a) of the Internal Security Act of 1950 provides that no deduction may be taken for any contribution to or for the use of any communist controlled organization.

A partner may deduct his share of charitable contributions made by the partnership. A nonresident alien may deduct charitable gifts only as to contributions made to domestic corporations, or to community chests, funds, or foundations created in the United States. Special legislation provides that gifts to or the use of the United States Naval Academy, the library of the Post Office Department, the Foreign Service, and the Commissary Fund of Federal Prisons are all considered as gifts to or for the use of the United States.

101. 1939, Sec. 23(o)(4).
102. 1954, Sec. 170(e)(5).
103. 64 STAT. 986, 50 U.S.C. 790.
104. 1954, Sec. 702; 1939, Sec. 183(c).
105. 1954, Sec. 873(e); 1939, Sec. 213(e).
A taxpayer may deduct the amount of an amortizable bond premium, provided the bond is of such a type that the interest thereon is included in gross income.\textsuperscript{107} If the interest on the bond is allowable as a credit under Section 35, the amount which would otherwise be taken into account in determining the credit is reduced by the amount of the amortizable bond premium for the year.\textsuperscript{108}

The amount of the premium is calculated with reference to the amount of the basis for determining loss on a transfer of such bond, and with adjustments proper to reflect the unamortized premium for the period before the date as of which the deduction becomes applicable with respect to the taxpayer's particular bond.\textsuperscript{109} The 1954 law adds that the determination of the premium amount is also made with respect to the sum payable on maturity or on an earlier call date, but if such call date is not more than three years after the issuance date, the premiums must be amortized to the maturity date rather than the call date. The new material applies only to bonds issued after January 22, 1951, and acquired after January 22, 1954.\textsuperscript{110}

The amortizable premium of the tax year is the amount of the premium attributable to that year.\textsuperscript{111} However, a new provision added to this limitation is that a taxpayer whose bond falls into the portion of the new "call date" provision discussed above, and which is actually called during the tax year, may deduct the remaining premium in the year of the call. The deduction, however, cannot exceed an amount equal to the excess of the adjusted basis of the bond (as of the beginning of the tax year) over the amount received on redemption, or maturity if such is greater.

The determinations required by the sections discussed in the two preceding paragraphs must be made in accordance with regulations of the Secretary detailing methods of so doing.\textsuperscript{112}

Certain classes of taxpayers holding particular types of bonds are allowed the benefits of these sections only if they elect to receive them.\textsuperscript{113} These classes are: an individual taxpayer holding bonds the interest on which is allowed as a credit in Section 35; and a taxpayer whose bonds are such that the interest is not excludable from gross income, but with respect to which neither the Section 35 credit nor the Section 242 deduction is allowable. The election must be made under regulations of the Secretary and applies to all bonds held by the taxpayer at the beginning of the first tax year in which the election takes effect. It is binding on subsequent years unless the Secretary permits revocation of the election. The 1954 Code omits the portion of Section 125(c) (2) of the earlier law concerning elections with respect to bonds of a partnership, as this section is now included in Section 703(b).

\textsuperscript{107} 1954, Sec. 171(a)(1) and (2); 1939, Sec. 125(a)(1) and (2).
\textsuperscript{108} 1954, Sec. 171(a)(3); 1939, Sec. 125(a)(3).
\textsuperscript{109} 1954, Sec. 171(b)(1); 1939, Sec. 125(b)(1).
\textsuperscript{110} 1954, Sec. 171(b)(1) (B).
\textsuperscript{111} 1954, Sec. 171(b)(2); 1939, Sec. 125(b)(2).
\textsuperscript{112} 1954, Sec. 171(b)(3); 1939, Sec. 125(b)(3).
\textsuperscript{113} 1954, Sec. 171(c); 1939, Sec. 125(c).
A "bond" is defined as any evidence of indebtedness issued by a corporation and bearing interest, but expressly excludes those which constitute the stock in trade of the taxpayer or which would be included in his inventory or which are held by him primarily for sale to customers. The new law, contra to the 1939 section, does not require the bond to contain "interest coupons" or be in "registered form."

Special rules apply to dealers in tax-exempt securities, such being set out in Section 75 of the new law, corresponding to 22(o) of the old.

**Net Operating Loss Deduction**

A deduction is allowed in each taxable year to the extent of the net operating loss carrybacks to such year plus the net operating loss carryovers to such year.115

"Net operating loss" is defined116 as the excess of allowable deductions over gross income, subject to certain modifications.117 Such excess is computed without regard to a net operating loss deduction, or long-term capital gains deductions, and the amount deductible on account of losses from transfer of capital assets cannot exceed the amount thereof includable on account of gains from such transfers. An individual taxpayer may include deductions not attributable to his trade or business only to the extent of the amount of his gross income so derived. In determining these latter amounts, the net operating loss deduction, long term capital gain deduction, and personal exemption deductions are taken into account, but not casualty losses deductions. The 1934 law adds that also to be so discounted is any gain or loss from the disposition of trade or business property which is subject to a depreciation allowance, or real property used in the trade or allowance.118 The effect of the new provision is that the taxpayer may include any loss on such sales as part of a net operating loss for the sale year. The "excess of deductions over gross income" calculation is also modified by new sections disallowing deductions for personal exemptions,119 which, of course, reaches the same result as the 1939 law due to personal exemptions now being considered as deductions rather than as subtractions from gross income. The 1934 Code also states that the amount of deductions is to be computed without regard to Section 246(b) and 247(a)(1)(B), which are limitations on deductions allowable for dividends received on certain preferred stock of public utilities and certain foreign corporations.120

The revised law allows a net operating loss carryback to each of the two taxable years preceding the loss year, in distinction to the prior enactment which carried it back only one year. The five year carryover is retained.121

114. 1954, Sec. 171(d); 1939, Sec. 125(d).
115. 1954, Sec. 172(a); 1939, Sec. 122(a).
116. 1954, Sec. 172(c); 1939, Sec. 122(c).
117. 1954, Sec. 172(d); 1939, Sec. 122(d).
118. 1954, Sec. 172(d)(4)(A).
119. 1954, Sec. 172(d)(3).
120. 1954, Sec. 172(d)(6).
121. 1954, Sec. 172(b)(1); 1939, Sec. 122(b).
In calculating the amount of the carryback and carryover, the entire amount of the net operating loss for the loss year is carried back to the earliest of the seven years mentioned in the preceding paragraph. So much of the carryback is applied to that year as to equal the taxable income for that year, computed with the same modifications used in determining the amount of a net operating loss (with certain named exceptions). Then the excess is taken forward to the next year and likewise so applied, etc., through the seven years (excluding the loss year) until the carryback or carryover is exhausted. An amended return is filed for past years so as to enable the taxpayer to take advantage of the carryback.

The tax law applying to any particular year is the law under which the computations as to the amount of carrybacks or carryovers in that year are made, per a newly added section. This provision coordinates years in which both new and old laws will apply.

Special rules are provided in the present Code concerning tax years beginning in 1953 and ending in 1954. Therein the amount of a net operating loss for such year is computed differently, and revises the amount of carryback which may be applied to certain preceding years. Section 172(g) of the 1954 law sets up transitional rules necessary in order to determine the number of years to which a loss can be carried back or forward, in view of the overlapping of the new and old laws.

Circulation Expenditures

Certain expenditures to establish, maintain or increase the circulation of a newspaper or magazine, etc., are deductible under both the new and old Codes. No substantive change has been made under the 1954 revision. As this section is chiefly applicable to the corporate taxpayer, discussion will be omitted here.

Research and Experiment Expenditures

The 1954 Internal Revenue Code includes an entirely new section permitting deductions for research and experimental expenditures. The law allows the taxpayer to choose one of two ways to treat the expenses.

Under Section 174(a), expenditures paid or incurred by the taxpayer during the tax year in connection with his trade or business may be treated as expenses not chargeable to the capital account and allowed as a deduction. This method may be adopted for any taxable year beginning after 1953 and ending after August 16, 1954, during which the research or experimental expenditures are made. With consent of the Secretary, the method may be adopted at any other time. Once elected, it must be retained until a change is approved by the Secretary.

122. 1954, Sec. 172(b)(2); 1939, Sec. 122(b).
123. 1954, Sec. 172(e).
124. 1954, Sec. 172(f).
125. 1954, Sec. 173; 1939, Sec. 23(bb).
126. 1954, Sec. 174.
A second method is provided for in Section 174(b). In the alternative to the manner provided above, the taxpayer may treat as deferred expenses any such expenditure which is chargeable to the capital account but not chargeable to property of a character which is subject to the depreciation allowance of Section 167 or the depletion allowance of Section 611. These deferred expenses are allowed as a deduction ratably over a period determined by the taxpayer, but which must extend over at least sixty months. This method may be elected only as to tax years beginning after 1953, and the election must be made before the tax return for the particular year is due. As in the first alternative, the method so elected must be retained until a change is approved by the Secretary. The election cannot be made as to previous years.

The Senate Finance Committee Report on H.B. 8300, Section 174, states that the second alternative is applicable only to the situation where such expenditures have no determinable useful life. If the useful life is determinable, the section is said to be inapplicable, and the capitalized expenditures must be amortized over that period.

Neither alternative is applied to any expenditure for the acquisition or improvement of land or for property to be used in connection with the research or experimentation, if the land is subject to the depreciation or depletion allowances of Sections 167 and 611. However, the deductions of the two mentioned sections may be considered as expenses for the purpose of this section.¹²⁷

The deduction does not apply to exploration expenditures.¹²⁸

Section 1016 (a) (14) states that adjustments to basis in respect to property must be made for amounts allowed as deductions under the second alternative, but only to the extent of the amounts allowable for the tax year and prior years.

**Soil and Water Conservation Expenditures**

Soil or water conservation expenditures, paid or incurred during the tax year by a taxpayer engaged in farming, in respect of land used for farming or for the prevention of erosion on such land, may be treated as expenses not chargeable to capital account, and if so treated, are allowable as a deduction.¹²⁹ This provision is an innovation of the 1954 tax law.

However, the amount so deductible cannot exceed 25 per cent of the gross income of the taxpayer derived from farming during the particular tax year. Any excess amount is carried forward to succeeding years until exhausted, with only an amount being applied in each of the following years to make up the difference, if any, between the conservation expenses of that year and the 25 per cent maximum amount allowable for that year.¹³⁰

¹²⁷ 1954, Sec. 174(c).
¹²⁸ 1954, Sec. 174(d).
¹²⁹ 1954, Sec. 175(a).
¹³⁰ 1954, Sec. 175(b).
"Gross income from farming" is not defined in the section. It would seem to include income from farms other than that on which the particular expenses were incurred.

The expenditures to which the section applies are defined\(^{131}\) as those paid or incurred for the treatment or moving of earth, including, among others, terracing, construction of ditches, dams, and ponds, and the eradicating of brush and planting of windbreaks, but not including the purchase or construction, etc., of facilities which are subject to the depreciation allowance of Section 167 nor any amount which is deductible under any other section. It expressly includes assessments levied by conservation or drainage districts for expenditures made by those groups which would be deductible under this section if spent by the taxpayer. "Land used in farming" includes property devoted to either agricultural products or livestock.

The taxpayer may adopt this method without the consent of the Secretary in his first tax year beginning after 1953 and ending after August 16, 1954, in which the expenditures are paid or incurred, or at any other time with the consent of the Secretary.\(^{132}\) The method adopted must be retained until a change is authorized.\(^{133}\)

**Additional Itemized Deductions for Individuals**

Sections 212 through 217 of the 1954 Code allow additional deduction to those mentioned previously, as provided in Section 211, subject to exceptions discussed ante. These allowances against taxable income correspond to those in Section 23 of the 1939 law.

**Expenses for the Production of Income**

Both Codes allow an individual to deduct the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income and for the management, conservation or maintenance of property held for the production of income.\(^{134}\) In addition, the 1954 revision allows the deduction of expenses incurred in any tax liability suit, whether federal, state or municipal, concerning any type of tax, whether imposed on estates, gifts, income, or property, etc.\(^{135}\)

**Medical Expenses**

A deduction is allowed for expenses paid during the tax year, for which there was no other compensation, for the medical care of the taxpayer, his spouse, or dependents.\(^{136}\) The deduction is permitted only to the extent that the expenses exceed three per cent of the adjusted gross income, or, if the taxpayer or his spouse has reached the age of 65 before the end of the tax year, the amount of the expenses

---

131. 1954, Sec. 175(c).
132. 1954, Sec. 175(d).
133. 1954, Sec. 175(e).
134. 1954, Sec. 212(1) and (2); 1939, Sec. 23(a)(2).
135. 1954, Sec. 212(3).
136. 1954, Sec. 213(a); 1939, Sec. 23(x).
for the care of the taxpayer and his spouse plus the amount that the expenses of the dependents exceed three per cent of the adjusted gross income. The 1939 law was not as liberal, as the deduction was calculated only on the excess above five per cent of the adjusted gross income. However, the new Code inserts a limitation that amounts paid for medicine and drugs can be taken into account only to the extent that they exceed one per cent of the adjusted gross income.137

A maximum deduction for medical expenses is set by the statute.138 The deduction may not exceed $2,500, multiplied by the number of personal exemptions allowed the taxpayer other than those for old age and blindness. The maximum is $5,000 if the taxpayer is single and not the head of a household nor a surviving spouse, or if he is married but files a separate return. The maximum is $10,000 if the taxpayer files a joint return with his spouse, or if he is the head of a household, or a surviving spouse. The 1939 maximum limits were exactly one-half the amounts stated above.139

A special rule is newly provided for in Section 213(d) of the new Code, in that expenses for the medical care of a deceased taxpayer which are paid out of the estate during the one year period following his death are treated as paid by the taxpayer at the time they were incurred. This rule does not apply, however, if the amount paid is allowable under Section 2053 as a deduction in computing the taxable estate of the deceased taxpayer unless a statement has been filed that such deduction has not been claimed under Section 2053 or unless a waiver of the right to claim the amount under that section has been filed.

“Medical care” includes amounts paid for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purposes of affecting any structure or function of the body, and including amounts paid for accident or health insurance.140 The new law adds “transportation primarily for and essential to medical care” described above. The addition excludes meals and lodging while away from home for medical treatment and travel expenses incurred by a taxpayer merely attempting to make his medical care more convenient or pleasant (such as a trip to summer states for a prescribed appendectomy). The section does not exclude, however, the cost of food and lodging included in a hospital bill, nor the cost of ordinary ambulance transportation.

Any expense which is allowable as a deduction under the next section to be discussed may not be treated as a “medical expense” under the new Code.141

Expenses for Care of Certain Dependents

The 1954 Internal Revenue Code has provided a completely novel deduction in Section 214. A taxpayer who is a woman or a widower may deduct expenses incurred

---

137. 1954, Sec. 213(b).
138. 1954, Sec. 213(c).
139. 1939, Sec. 23(x).
140. 1954, Sec. 213(e); 1939, Sec. 23(x).
141. 1954, Sec. 213(f).
during the tax year for the care of his or her dependents, provided the care is for
the purpose of enabling the taxpayer to be gainfully employed. The deduction is
limited, however, to $600, regardless of the number of dependents or the amounts
above the maximum actually spent. Nor does it apply to any amount paid to a
person for whom the taxpayer is entitled a personal exemption under Section 151,
thereby preventing a double deduction by paying an older child to take care of one
younger, etc.

In the case of a married woman, the deduction is not allowed unless she files a
joint return with her husband, and it is reduced by the amount by which the ad-
justed gross income of the taxpayer and her spouse exceeds $4,500. However, the
provisions in this paragraph do not apply if the husband is mentally or physically
incapable of self-support.

For the purposes of this section, a "dependent" is limited to those persons for
whom the taxpayer may claim a personal exemption under Section 151, provided
that person is a child or step-child under the age of 12, or who is physically or
mentally incapable of caring for himself regardless of age or relation. As in other
sections of the Code, a "widower" includes an "unmarried individual who is legally
separated from his spouse under a decree of divorce or separate maintenance."

The section is worded so as to permit the deduction of expenses incurred only
while the taxpayer is working or seeking work. In the case where the maid, etc.,
does other work for the taxpayer in addition to caring for the dependent, the Code
would seem to require a pro-rating of the expense.

Alimony Payments

If the taxpayer is a husband divorced or legally separated from his wife, he
may deduct any payments made during his taxable year to his wife, provided such
amounts are included in her gross income. The amounts so included set forth
in Section 71 of the new law, are: periodic payments received after the decree in
discharge of a legal obligation imposed on the husband due to the marital or family
relationship and incurred under the decree or written instrument incident to the
divorce or separation; periodic payments to the wife under a separation agreement;
and periodic payments to the wife as required by a decree ordering the husband
to make payments for her support or maintenance. Payments to the support of
minor children are not deductible, as they are not included in the gross income of
the wife.

The section states no deduction of these amounts is allowed if they are includable
in the gross income of the wife and attributable to transferred property, or should
they be payments under a trust which the terms of the divorce or separation

142. 1954, Sec. 215; 1939, Sec. 23(u).
143. 1954, Sec. 71(d).
agreement or trust itself set up as payable for the support of the minor children of the husband.144

“Husband” and “wife” are defined for the purposes of the deduction above to include “former wife or husband”, and a taxpayer-wife may take the deduction should the payments be made by her to the husband.145

Payments to Housing Corporations

Amounts paid or accrued to a cooperative housing corporation within the tax-able year may be deducted by the taxpayer, provided he is a tenant-stockholder in the corporation.146 However, the allowance is permitted only to the extent of the taxpayer’s proportionate share of real estate taxes and interest paid or incurred by the corporation for which it may take a deduction under Sections 164 and 163. The interest mentioned must be incurred on debts for the acquisition or construction, etc., of the houses or buildings or for the land on which they are situated.

The 1939 Code is the same as the revised edition, except that it restricted the application to amounts paid to “cooperative apartment corporations”, rather than to the broader “cooperative housing corporation” of the 1954 law.

The section actually accomplishes the result of allowing a taxpayer to take the deductions for interest and taxes to which he would be entitled should he own his own home rather than be a stockholder in the cooperative group.

“Cooperative housing corporation” is defined as a corporation having only one class of stock, whose shareholders are entitled to occupy a dwelling owned or leased by the group solely by reason of his stock ownership, subject to the limitation that no stockholder be entitled to receive any distribution not out of profits except on liquidation and that 80 per cent of the gross income of the corporation be derived from the tenant-stockholders. The “tenant-stockholder” must own stock in the corporation, paid up in an amount bearing a reasonable relation to the corporation’s equity in the dwelling and land which the individual is entitled to occupy.

Deduction for Capital Gains

An individual taxpayer may claim a deduction of 50 per cent of the excess of his net long-term capital gains for the tax year over the net short-term capital losses for that year.147

In determining this deduction in the case of an estate or trust, the computation must exclude any portion of the gains for the tax year from sales or exchanges of capital assets, which, under Section 652 and 662 relating to inclusions of amounts

144. 1954, Sec. 682.
145. 1954, Sec. 7701(a)(17).
146. 1954, Sec. 216; 1939, Sec. 23(z).
147. 1954, Sec. 1202; 1939, Sec. 23(ff) and 117(b).
in the gross income of beneficiaries of trusts, is includible by the income beneficiaries as gain derived from the sale or exchange of capital assets.

The 1954 law has made no changes from the earlier Code in respect to this provision.

Deductions for Decedents

The deductions permitted in Sections 162, 163, 164, and 212 relating to expenses, interest, and taxes, in respect of a decedent which are not properly allowable to him in respect of the tax year in which he died, are allowed to the estate of the decedent, except that in the case where the estate is not liable to discharge the obligation to which the deduction relates, the allowance may be taken by the person who acquires the interest from the decedent through distribution. As to the depletion deduction of Section 611, the allowance may be taken by the person who, under Section 691(a) (1), is held to have received the items of gross income in respect of a decedent which are not properly includible in respect of the tax year in which decedent died.

ITEMS NOT DEDUCTIBLE

As stated in Section 261 of the 1954 Code, no deduction is allowed with respect to the items specified in Sections 262 through 273.

Personal, Living, and Family Expenses

No deduction is allowed for personal, living, or family expenses, unless otherwise so provided. This constitutes no change from the prior law.

Capital Expenditures

No deduction is allowed for amounts paid out for new buildings, permanent improvements, or betterments made to increase the value of any property. Express exceptions are made for expenditures for the development of mines or deposits deductible under Section 616. The 1954 Code makes two additional exceptions of research and experimental expenditures deductible under Section 174 and soil and water conservation expenses deductible under Section 175. Neither law permits a deduction for amounts spent in restoring property or in making good an exhaustion for which another allowance has been or is made.

Certain Insurance Payments

No deduction is allowed for premiums paid on life insurance policies covering the life of any officer or employee or any person financially interested in any trade or business carried on by the taxpayer, when the taxpayer is directly or indirectly

---

148. 1954, Sec. 691(b); 1939, Sec. 128(b).
149. 1954, Sec. 262; 1939, Sec. 24(a)(1).
150. 1954, Sec. 263(a); 1939, Sec. 24(a)(2) and (3).
151. 1954, Sec. 263(a)(1)(B) and (C).
152. 1954, Sec. 263(a)(2); 1939, Sec. 24(a)(3).
a beneficiary of the policy.\textsuperscript{153} Nor is any allowance made for amounts paid or accrued on indebtedness incurred or continued in order to purchase or carry a single premium life insurance or endowment contract.\textsuperscript{154} The 1954 Code adds to those contracts mentioned any annuity contract purchased after March 1, 1954.

A contract is treated as "single premium" if substantially all the premiums are paid within a 4-year period after its purchase,\textsuperscript{155} or, under a newly inserted provision of the 1954 law, if an amount is deposited after March 1, 1954, with the insurer for payment of a substantial number of future premiums on the contract.

\textbf{Expenses Relating to Tax-Exempt Income}

No deduction is allowed for any amount otherwise deductible which is allocable to one or more classes of income other than interest wholly exempt from tax, nor for any amount deductible under Section 212, relating to expenses for production of income, which is allocable to interest wholly exempt from tax.\textsuperscript{156}

Interest on indebtedness is not allowable as a deduction if it is incurred or continued in order to purchase or carry obligations on which the interest is wholly exempt from tax.\textsuperscript{157}

No changes have been made in the new law in this section.

\textbf{Carrying Charges}

Taxes and carrying charges are not deductible if they are chargeable, under the regulations of the Secretary, to capital account with respect to property, provided the taxpayer has elected to so treat the taxes or charges as so chargeable.\textsuperscript{158} No alterations have been made by the 1954 Code.

\textbf{Transactions Between Related Taxpayers}

No deduction is allowed with respect to losses from direct or indirect sales or exchanges of property between certain persons specified.\textsuperscript{159} As relating to individuals, these persons are: an individual's spouse, ancestors, lineal descendants, or brothers and sisters of half or whole blood; an individual and a corporation over half of which is owned directly or indirectly by the individual; two corporations over half of which are owned directly or indirectly by an individual if either is a personal holding company; a grantor and fiduciary of trust; the fiduciaries of two trusts, the grantor being the same individual in both; or a fiduciary and beneficiary of a trust.\textsuperscript{160} To those named above, the 1954 Code adds: a fiduciary of one trust and

\textsuperscript{153} 1954, Sec. 284(a)(1); 1939, Sec. 24(a)(4).
\textsuperscript{154} 1954, Sec. 284(a)(2); 1939, Sec. 24(a)(6).
\textsuperscript{155} 1954, Sec. 284(b); 1939, Sec. 24(a)(6).
\textsuperscript{156} 1954, Sec. 265(a); 1939, Sec. 24(a)(5).
\textsuperscript{157} 1954, Sec. 265(b); 1939, Sec. 23(b).
\textsuperscript{158} 1954, Sec. 266; 1939, Sec. 24(a)(7).
\textsuperscript{159} 1954, Sec. 267(a); 1939, Sec. 24(b)(1).
\textsuperscript{160} 1954, Sec. 267(b); 1939, Sec. 24(b)(1).
beneficiary of another, if the grantor of both is the same individual; a fiduciary of a trust and a corporation over half of which is owned directly or indirectly by or for the trust or a grantor of the trust; and a person and certain educational and charitable organizations which are exempt from tax under Section 501 and which are controlled directly or indirectly by the person or members of his family.

Special rules are provided in determining who owns stock for the purposes of this section. Stock held by a corporation is deemed held by its shareholders. An individual is considered to own the stock held by his immediate family or his partner. Constructive ownership provided for in the preceding sentence is not to be applied again under the same rule so as to put the constructive ownership in another person.

A new provision is presented in Section 267(d). In the case of a sale or exchange of property to the taxpayer, if a loss sustained by the transferor is not deductible under the provisions discussed above and the taxpayers disposes of the property after 1953 at a gain, then the gain is recognized only to the extent that it exceeds the amounts of the loss not previously allowable to the transferee and not to donees in any case.

Unharvested Crop Sales

No deductions are allowed at all where an unharvested crop considered under Section 1231 as "property used in the trade or business" is sold by the taxpayer. The new law remains the same as the old in this section.

Acquisitions Made to Avoid Tax

If any taxpayer obtains control of a corporation, directly or indirectly, for the purpose of evading or avoiding income tax by securing the benefit of any deduction or other allowance to which he would otherwise not be entitled, the allowance cannot be taken. "Control" is defined as ownership of 50 per cent of the voting shares or 50 per cent and of all the shares of the corporation.

However, the Secretary is authorized to permit the allowances, or any part thereof, if he determines that the allowance actually will not result in a tax evasion or avoidance, regardless of intention.

The 1954 Code has provided new procedural devices in determining the purpose of the acquisition. The section states that the fact that the consideration paid on acquisition is substantially disproportionate to the adjusted basis of the property and to the tax benefits unavailable to the person otherwise than as a result of the

161. 1954, Sec. 267(c); 1939, Sec. 24(b)(2).
162. 1954, Sec. 268; 1939, Sec. 24(f).
163. 1954, Sec. 269(a); 1939, Sec. 129(a).
164. 1954, Sec. 269(b); Sec. 129(b).
165. 1954, Sec. 269(c).
transfer, is considered prima facie evidence of a purpose to evade or avoid the tax. However, this presumption applies only as to transfers after March 1, 1954.

Certain Limitations on Deductions

If the allowable deductions attributed to a trade or business carried on by the taxpayer have exceeded the gross income of the trade or business by more than $50,000 over each of five consecutive years, including at least one year to which the 1954 income tax laws apply, the taxable income of the individual for those years is recomputed, and the deductions mentioned are allowed only to the extent of $50,000 above the gross income, and in that recomputation no net operating loss deduction is allowed at all.166

The new Code lists several specially treated deductions which are excluded in making the determination above.167 These are: taxes, interest, casualty and abandonment losses connected with a trade or business which are deductible under Section 165(c)(1); losses and expenses of the trade or business of farming which are directly attributable to drought; the net operating loss deduction allowed by Section 172; and any expenditures as to which taxpayers are given the option to either deduct as expenses when incurred or to defer or capitalize.

Both Codes provide that if, in redetermining the tax for the five prior years, tax is found to be owing by the taxpayer, such amounts are considered as deficiencies in respect to the operation of any law or rule prohibiting the assessment of deficiencies.168 The statute of limitations for the assessment of deficiencies has been extended, however, and any such deficiency can be assessed with respect to its taxable year as though, at the time the period of the statute would ordinarily expire, one year remained before such expiration.169

Debts Owed by Political Parties, Etc.

No deduction for bad debts under Section 166 or for the worthlessness of securities under Section 165(g) is allowed by reason of the worthlessness of any debt owed by a political party.170 The new law makes no changes with respect to this section.

A "political party" includes the party itself or any national, state or local committee thereof, or any group which accepts contributions or makes expenditures for the purpose of attempting to influence the election of any public officer. "Contributions" includes, in addition to its obvious meaning, loans and promises to make contributions. "Expenditures" likewise includes loans, gifts, payments, and contracts to make expenditures.

166. 1954, Sec. 270(a); 1939, Sec. 130(a).
167. 1954, Sec. 270(b).
168. 1954, Sec. 270(e); 1939, Sec. 130(b).
169. 1954, Sec. 270(d); 1939, Sec. 130(c).
170. 1954, Sec. 271; 1939, Sec. 23(1)(6).
Disposal of Coal

In the case of any owner of coal, who disposes of it as in Section 631(c) under a form of contract in which the owner retains an economic interest in the coal, no deduction is allowed for expenses attributable to the making and administering of such contract, or to the preservation of such economic interest retained. This is a new provision of the 1954 Code.

However, if the expenses mentioned above in any tax year plus the adjusted depletion basis of the coal disposed of in that year exceeds the amount realized under the contract, the excess may be considered deductible under Section 165(a) relating to losses, to the extent such excess is not availed of as a reduction of gain under Section 1231.

Holders of Life or Terminable Interests

Amounts paid under the laws of a state, territory, possession of the United States or foreign country as income to the holder of a life or terminable interest acquired by gift, bequest or inheritance are not reduced by any deduction for diminution in the value of the interest due to the lapse of time.

In respect to the above provisions, the new and old law coincide, but the 1954 edition has eliminated a further portion of the 1939 section which denied the holders of these interests any deduction allowed in the Code other than for depreciation and depletion. The purpose of the deletion is to correlate the new changes made in the taxation of estates and trusts, wherein such deductions are allowable to beneficiaries to the extent they are not used by the state or trust.

STEPHEN E. STROM

171. 1954, Sec. 272.
172. 1954, Sec. 273; 1939, Sec. 24(d).