REPORT TO THE SUBCOMMITTEE

ON

EXCISE TAX TECHNICAL AND ADMINISTRATIVE PROBLEMS

HOUSE COMMITTEE ON WAYS AND MEANS

Prepared by the Staffs of the

Joint Committee on Internal Revenue Taxation and

Treasury Department

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JANUARY 9, 1956.

Hon. AIME J. FORAND,
Chairman, Subcommittee on Excise Tax Technical and Administrative Problems,
Committee on Ways and Means,
House of Representatives, Washington, D. C.

DEAR MR. FORAND: There is transmitted herewith a joint report of the staffs of the Treasury (including the Internal Revenue Service) and the Joint Committee on Internal Revenue Taxation on excise tax technical and administrative problems. Mr. Riddell, professional staff member of the Committee on Ways and Means, has participated in these studies.

Respectfully yours,

COLIN F. STAM,
Chief of Staff,
Joint Committee on Internal Revenue Taxation.

DAN THROOP SMITH,
Special Assistant to the Secretary of the Treasury in Charge of Tax Policy.

SUMMARY OF RECOMMENDATIONS

I. General

A. FULL AGREEMENT

1. Warranties

A readjustment in sales price giving rise to a credit or refund should not be made with respect to the expenses sustained by a taxpayer in fulfilling his warranty.

Where the taxpayer makes a separate compulsory charge, the definition of sales price for purposes of the retailers and manufacturers taxes should be amended to include specifically compulsory charges for the warranty of the articles.

It is believed that the report accompanying such legislation should indicate that it is declaratory of the intent of Congress as originally expressed in enacting section 6416 (b) (1) of the 1954 code and corresponding provisions of the 1939 code and prior laws.

2. Cooperative advertising

The status of cooperative advertising in relation to a manufacturers tax base should be clarified by a specific ruling of the Internal Revenue Service to provide substantially as follows:

(1) Where a manufacturer's selling price to his customer contains an unsegregated advertising charge, it is a part of his tax base.

(2) In the case where a manufacturer makes a separate charge to his distributor for advertising and the proceeds are kept in a separate account earmarked for advertising, the separate advertising charge is not a part of the tax base provided the charge is either listed on the sales invoice or billed separately; the contributions from distributors are set aside as a fund to be used for advertising for the benefit of these contributors; and the funds are so used or the unexpended portion is held in trust or refunded to the contributor upon his withdrawal from the program.

(3) Where the manufacturer makes a contribution to the advertising account in the case of a separate fund, the amount of the manufacturer's contribution may not be deducted in computing the taxable sale price. Subsequent allowances from such contributions to distributors for expenditures by them or their dealers in advertising should be treated as readjustments of sale price under section 6416 (b) (1) of the code.

3. Sale of installment accounts

Uncertainty as to congressional intent with respect to the tax to be paid upon the sale of installment accounts at less than face value should be resolved by statute. The rule now applied by the Service requiring payment of tax upon face value irrespective of the selling price with, however, payment of the tax on the selling price in bankruptcy and receivership cases is proposed as being a reasonable one if the rule used for bankruptcy and receivership sales is extended to similar sales under any other legally distressed situation.

4. Installment accounts under Louisiana law

To make it clear that taxpayers in Louisiana are to have the privilege of deferring their tax payments under the installment type of contract which is recognized under Louisiana law, sections 4053 and 4216 (c) should be appropriately amended.

5. Consolidated returns

Statutory authority should be given the Secretary of the Treasury or his delegate so that he may authorize by regulations (subject to such limitations and conditions as appear appropriate or administratively desirable) a person liable for the filing of returns of retailers taxes and the transportation of property tax designate his supplier or shipper to perform such acts as are required of him in connection with the filing of returns relating to such taxes.

II. Manufacturers Excises

A. FULL AGREEMENT

1. Rebuilt automotive parts

In regard to the reconditioning, rebuilding, and repairing of automotive parts, the Service will reexamine its latest published ruling on treatment of generators to evaluate its consistency with the present treatment accorded to the rebuilding of automobile engines.

2. Electric direct-motor driven fans and air circulators

Electric direct-motor driven fans and air circulators should be taxed only if they are of the household type.

3. Definition of radio and television components

The tax on television and radio components should be applied only to those components which are suitable for use on or in connection with entertainment type sets.

B. AGREEMENT IN PRINCIPAL

4. Leases

The tax on articles leased instead of sold should be limited to the tax that would have been due had the article been sold, but only if some sales of the articles are made.

III. Retailers Excises

A. FULL AGREEMENT

1. Semiprecious stones purchased by lapidarists

The test of taxability of semiprecious stones should turn upon the finished state of the stone. They should be subject to tax only when cut or polished.

2. "Basket clause" under luggage tax

The "basket clause" in section 4031 should be removed and in lieu thereof a somewhat longer list of articles should be made subject to the tax.

IV. Excises on Facilities and Services

A. FULL AGREEMENT

1. Geographical scope of general admissions tax

The law should definitely state that the admissions tax applies only to events that take place in the United States.

2. Exclusive use of cabaret premises

The Internal Revenue Service is to issue new rulings under the cabaret tax to provide that where a private organization conducts an affair in a room customarily and regularly used as a cabaret and negotiates with the proprietor to provide the dinner and any other services desired but not for the entertainment, the cabaret tax will not apply if the private organization by independent negotiations provides its own entertainment and the entertainers are not regularly employed by the proprietor both prior to and after the affair in question.

3. Collection of tax on amounts paid to concessionaires at cabarets

The proprietor, owner, or lessee of a cabaret should be required to collect the cabaret tax due from concessionaires and include such amounts when making his monthly deposits and quarterly returns with other payments received by such proprietor for admission, refershments, service, or merchandise.

4. Life memberships in social clubs

The annual tax on life memberships should be equivalent to the tax on the annual dues and membership fees of the type of annual membership providing privileges most nearly like that of the life membership.

5. Communication taxes

It is agreed that a study should be made of the communications taxes to determine whether they should be revised substantially to conform to modern techniques and to remove any competitive problems which may exist.

V. Documentary Stamps

A. FULL AGREEMENT

1. Partnership treatment

The so-called entity rule should be adopted for transfers of partnership interests in the case of the documentary stamp taxes.

2. Payment of transfer taxes through national securities exchange by check

The purchase of stamps by clearinghouses of national security exchanges should no longer be required and instead clearinghouses should be required to make daily payment by check to an authorized Government depository of the total amount of taxes shown on the broker-member's reports.

3. Exemption certificates

The statutory requirement for exemption certificates under the documentary stamp taxes should be liberalized.

4. Return of stock or certificates of indebtedness deposited as collateral security

The transfer tax should not apply to the return of stock or certificates of indebtedness deposited as collateral security.

5. Basing the stock issuance and transfer taxes on the actual value rather than par value

The stock transfer and issuance taxes should be revised as follows:

(1) The tax on the transfer of stock or stock rights would, in general, be 5 cents on each $100 or major fraction thereof of the actual value of each certificate (or of the share where no certificate is transferred). The minimum tax per certificate (or share where no certificate is transferred) however, would be 5 cents. The rate would be 5 cents per share in the case of transfers which do not involve a sale or exchange for value.

(2) In the case of the stock issuance tax, the rate would be 10 cents on each $100 or major fraction thereof of the actual value of each certificate (or of the shares where no certificate is issued). The minimum tax in any case would be 10 cents per certificate (or share if no certificate is issued).

6. Definition of certificates of indebtedness

The statute should specify that certain notes which are more in the nature of certificates of indebtedness than promissory notes should be subject to the documentary stamp tax as certificates of indebtedness. The test could be based upon the length of time for which the note is issued.

7. Transfers of worthless certificates of indebtedness

Transfers made by an executor or administrator of certificates of indebtedness to a legatee, heir, or distributee should be exempt from the tax if the value of the certificates is not greater than the amount of the tax involved. This would extend the present rule for stocks to certificates of indebtedness.

B. AGREEMENT IN PRINCIPLE

1. Tax on issuance of stock where earned surplus is dedicated to capital account

As a matter of principle, no issuance tax should be asserted on the mere dedication of earned surplus to capital.

2. Statutory mergers and consolidations

In the case of statutory mergers and consolidations the present double tax should be eliminated and only the tax imposed by section 4301 on the issuance of shares or certificates of stock should be made applicable. This should be limited to cases where the stock or certificates of stock are issued directly by the acquiring corporation to the security holders of the component corporation.

3. Odd-lot transactions

It is agreed that one of the two taxes on odd-lot transactions be eliminated.

VI. Wagering Tax and Taxes on Coin-Operated Machines

A. FULL AGREEMENT

1. Liability of "runners" for the tax on wagers

It is recommended that the law be amended so that an agent who refuses or is unable to name his principal shall be deemed prima facie the principal for the purposes of the 10 percent excise tax on wagers.

2. Coin-operated amusement devices actuated by remote control

The definition of a coin-operated amusement device should include the type which is actuated by remote control without the use of a coin.

VII. Exemption and Refund Procedures

A. FULL AGREEMENT

1. Major exemption and refund or credit provisions

A more uniform system of exemptions and refunds or credits is recommended for manufacturers' sales (or resales) for further manufacture, for export, to State and local governments, and for fuel supplies, etc., for certain vessels and aircraft. Such rules should also be followed where applicable, in the case of retailers taxes and the taxes on communications and transportation. This would be done by providing for the permanent registration of purchasers for any of the exempt purposes and tax-free sales would be made only to such purchasers. Tax-free sales would not require the use of exemption certificates but would be evidenced by a notation on the sales invoice of the registration number of the exempt purchaser. Where a sale is made by the initial manufacturer on a tax-paid basis and the purchaser subsequently uses or sells the article for one of the prescribed exempt purposes, a refund or credit should be allowed upon proof of such a sale. The refund or credit would be allowed whether or not there had been an indication at the time of the initial purchase that the article was intended for use for one of the specified exempt purposes. The refund or credit should be made through the initial manufacturer.

2. Special exemption and refund problems

(a) Areas of double taxation or faulty applications of exemptions

(1) *The credit for tires, tubes, and auto radio and television sets.*—The crediting device presently provided in section 6416 (c) in the case of the excise tax on automobiles and trucks could be extended to any manufacturers excise tax. With respect to articles sold for export or to State or local governmental units, tax-free sales (or credits or refunds) could be allowed in the same manner as for other articles sold for export or to State or local governmental units.

(2) *Problems arising where clocks are combined with other articles.*—Provision should be made in the statute that where clocks are combined with other articles subject to a manufacturers excise tax the manufacturers tax is to apply to the entire combination in the manner now prescribed by ruling.

(b) Technical problems in the manufacturers taxes

(1) *Sale of certain parts or components as repair or replacement parts.*—Section 4220 should be amended to carry out the intent of Congress

as was stated in both the House and Senate reports in Public Law 367, 84th Congress, that "the adoption of a single rule exempting parts, accessories, or components from tax except where they are sold for repair or replacement use, will provide greater equity and simplify administration and compliance." Therefore it should be made clear that parts or components sold for repair or replacement are still subject to tax.

(2) *Use by manufacturer of certain parts or components.*—Section 4218 should be amended to make it clear that with respect to automobile parts and accessories, radio and television components, refrigerator components, and camera lenses, a tax is still to be imposed where such parts are used by the manufacturer as repair or replacement parts.

(3) *The definition of refrigerator components.*—The exception in section 4221 that the term component means certain specified parts "except when sold as component parts of complete refrigerators, refrigerating or cooling apparatus, or quick freeze units (hereinafter referred to as 'refrigerating equipment') is no longer necessary since Public Law 367 achieves the same results on a broader basis.

(*c*) *Documentary stamp taxes*

(1) *Statute of limitations for stamp taxes.*—Section 6501 should be amended to provide that the period of limitations should commence running in the case of an assessment from the time the stamp tax is paid rather than from the time the tax became due. Section 6805 (a) should be amended by striking out the third and fourth categories for which redemption can be made, i. e., those where the stamp has been improperly or unnecessarily used and where the rates and duties have wrongfully been collected. Subsection (c) of this section which provides the redemption period of 3 years from the date of purchase should be amended to make it applicable only to unused stamps.

(2) *State and local government tax liability in the case of real-estate conveyances.*—The treatment presently provided by ruling exempting State and local governmental units from the tax on conveyances should be added to the statute but no distinction should be made between transfers or acquisitions for governmental as distinct from proprietary functions.

(*d*) *Club-dues tax*

(1) *Power of attorney required in the case of claims for credit or refund.*—An indication of consent from members, rather than the execution of a power of attorney, would be acceptable in the future as a basis on which to allow a credit or refund. The procedure to be followed would be substantially that which is now followed as in the case of manufacturers excise taxes.

(2) *Refund of tax in the case of refund of initiation fee.*—Section 6415 (d) as now interpreted by the Service seems to carry out the original intent that a refund on an initiation fee that is repaid to a member should be made irrespective of when the initial payment was made.

(*e*) *Cabaret tax and transportation of oil by pipeline.*

Section 6416 should be revised to make it clear that a refund of a cabaret tax and the tax on the transportation of oil by pipeline will be made where the amount of the tax has been repaid to the consumer of the service or where the consumer of the service gives permission to the performer of the service to the allowance of the credit or refund.

VIII. Floor Stock Refunds

A. FULL AGREEMENT

1. *General revision of present floor stock refunds of manufacturers' excises.*—The system used under the Excise Tax Reduction Act of 1954 was found to be, generally speaking, satisfactory. The following changes should be made:

(*a*) Dealers should be required to file their claims with the manufacturers at some time prior to the time manufacturers have to file their claims. A period of 2 months and 10 days after the rate reduction should be allowed for the filing of these claims with the manufacturers. Manufacturers would then be given an additional period of at least 1 month or possibly as much as 3 months for the compiling of these claims of the dealers and making a claim to the Government.

(*b*) Manufacturers should not be required to pay dealers their claims prior to the time the manufacturers file their claims or even prior to or at the time the manufacturers receive the benefit of the credit or refund from the Government. Instead the manufacturers should be required to state that within 30 days after they receive a refund or credit they will pass it on to the dealers.

(*c*) The filing of claims by manufacturers should be integrated with the filing of their quarterly excise tax returns.

2. *Price reduction requirement for gasoline.*—The requirement that gasoline prices be reduced to reflect the refund on tax-paid floor stocks seems no longer necessary because of general competitive conditions and should be repealed.

3. *Automobile parts and accessories.*—The technical error in the 1954 code which provides for floor stock refunds on automobile parts and accessories should be corrected as this was not the intention of Congress.

4. *Sugar.*—Since the time for filing claims for all other floor stock refunds is based on statutory time limits, one should be provided in the case of tax-paid imported sugar or imported products composed in chief value of manufactured sugar.

5. *Alcoholic beverages and cigarettes.*—Since the price-reduction provision for alcoholic beverages and cigarettes was eliminated by the 1954 code, it is no longer necessary to require claimants of refunds to keep the detailed records of the type prescribed in the law, and this provision should be deleted.

IX. Adjustment of Price on Sales to Selling Subsidiary

The statute should be amended to include the presumption that a sale to a selling subsidiary is not at arm's length.

X. Optional Return System for Cigar Tax

To meet the special problems of cigar manufacturers who desire to have more flexibility in marketing than is possible with the use of stamps, the Treasury Department will authorize the use of a a daily return system on an optional basis for cigar manufacturers.

PART 1: SPECIAL EXCISE TAX PROBLEMS

I. GENERAL

A. Full agreement

1. Warranties.—The United States Court of Claims in the case of *General Motors Corporation, Frigidaire Division* v. *the United States* (121 F. Supp. 932) held that the separate charge for a 5-year warranty which a vendee had to purchase with each refrigerator was part of the manufacturer's sale price of the refrigerator. However, the court also held that the taxpayer is entitled to a refund of a portion of the tax paid equal to the ratio of the expenses incurred in the repair or replacement of refrigerators under such a warranty to the original sale price of the article. A writ of certiorari filed with the Supreme Court of the United States to obtain review of the decision was not granted.

The decision is subject to the much broader interpretation that refund must be allowed a manufacturer or retailer with respect to tax attributable to expenses incurred in the repair or replacement of a taxable article pursuant to a warranty, express or implied, even though no specific or separate charge is made. The court stated:

> When an article is sold with a warranty, and fulfillment of the warranty costs the seller a certain sum, he has in fact received for the article only the amount by which the sale price exceeded the cost of fulfilling the warranty. He has, in effect, given the purchaser an "allowance" when he has spent money for his benefit.

The Court of Claims arrived at its conclusion by interpreting section 3443 (a) (2) of the Internal Revenue Code of 1939 (now sec. 6416 (b) (1) of the Internal Revenue Code of 1954) as meaning that the "price" of the article "is readjusted" when the article is repaired or replaced without charge in accordance with a warranty. This conclusion is contrary to the Government's position continuously in effect since this statutory provision was first enacted in 1932. The decision applies to the long list of articles subject to manufacturers' and retailers excise taxes.

The decision does not appear to be in accord with the intent of Congress in enacting the statutory provision referred to. Section 621 (a) (2) of the Revenue Act of 1932, which first introduced this test into the law, provides as follows:

> **SEC. 621. CREDITS AND REFUNDS**
>
> (a) A credit against tax under this title, or a refund, may be allowed or made——
>
> * * * * * * *
>
> (2) to any person who has paid tax under this title with respect to an article, when the price on which the tax was based is readjusted by reason of return or repossession of the article or a covering or container, or by a bona fide discount, rebate, or allowance; in the amount of that part of the tax proportionate to the part of the price which is refunded or credited.

The report of the Committee on Ways and Means contains the following in explanation of the provision:

> This last provision covers readjustments such as cash or quantity discounts, credit for return of goods or containers, and any other bona fide rebate or allowance *amounting to a change in the sale price.* [Italic supplied.]

Where a manufacturer, under a warranty, repairs or replaces an article of his manufacture which is defective, the sale price of the article on which the tax was based has not been changed. The manufacturer, in making the repair or replacement, has merely furnished the purchaser at a later date with the kind and quality of merchandise which should have been, but was not, delivered in the first instance. There is no "readjustment" of the "price" of the article since no consideration flows to the purchaser. Rather, there is a readjustment in the article itself to make it serve the purpose originally intended. The expense of making good on the warranty is part of the "cost" of manufacturing the article made necessary by the manufacturer's original failure in producing the article. Such expenses are taken into account in determining the manufacturer's profit for income tax and similar purposes, but they do not have the effect of readjusting the "price" of the article (the consideration received by the manufacturer from his purchaser), which is the type of readjustment contemplated by the law for the allowance of a refund or credit.

The tax is based on the price paid the manufacturer for the article and is passed on to the customer either directly by a separate charge or indirectly by including the amount in the price of the article. Thus, the ultimate purchaser who bore the burden of the tax will derive no benefit from the refund or credit granted the manufacturer. In effect, the purchaser pays a greater tax on the article than is retained by the Government.

A large amount of revenue will be lost if expenses incurred by manufacturers and retailers in fulfillment of warranties are allowed. The Internal Revenue Service has made a survey of district directors' offices under the five regional commissioners in New York, Chicago, San Francisco, Philadelphia, and Cincinnati to determine the claims which thus far have been filed on the basis of the Frigidaire decision. These regions contain the chief manufacturing centers for articles subject to manufacturers' excise taxes.

The reports show that claims pending in district directors' offices in these regions as of September 1, 1955, have been filed by only some 70 taxpayers but already amount to $55 million. Many of the claims relate only to earlier periods in order to protect the claimants against the running of the statute of limitations. It is expected that the same claimants will file further claims covering later periods. In addition a large number of manufacturers have not yet filed claims. It is anticipated that all claims involved up to the present time alone will be many times $55 million.

Moreover, the decision will result in a substantial administrative burden in processing numerous claims without any statutory or judicial guidance as to what type of expenses incurred by the manufacturer or retailer may be charged to the repair or replacement of the article. For example there is nothing in the court decision, nor in the law, to show whether overhead costs are to be included in determining the repair expenses and, if so, what type of overhead expenses may be

allowed, whether the manufacturer's sale price of a part used in the repair or the actual direct cost of making such part is to be considered as part of the repair expenses. There is also a question whether transportation, delivery, insurance, installation, and similar costs are to be included as repair expenses for which refund is to be computed, since such costs under the law are excluded in establishing the sale price on which tax is originally computed. Claimants have included the following items of costs in justifying the amounts claimed: (1) direct labor; (2) parts; (3) applied standard burden; (4) payments made to authorized service agencies; (5) transportation charges on the incoming unit for repair; (6) transportation charges on the outgoing repaired unit; (7) factory supplies; (8) expense of clerical billing; (9) factory clerical expense; (10) payroll taxes; (11) warehousing of repair parts; (12) office salaries and supervisory expense; (13) stationery and office supplies; (14) travel expense; (15) salaries of repairmen in field; (16) outside sales expense; and (17) amounts reimbursed for local advertising. Many of these expenses could not be determined accurately and claimants of necessity have made arbitrary allocations.

It is evident that the Frigidaire decision will involve a substantial loss of Government revenue not previously anticipated, be difficult to apply because the lack of statutory guidance, and is not in accord with congressional intent.

Therefore, it is suggested that the code be amended to make clear that a readjustment in sale price giving rise to a credit or refund does not occur with respect to the expenses sustained by a taxpayer in fulfilling his warranty.

In order to lay at rest any question as to application of the tax in the case where the taxpayer makes a separate compulsory charge it is also suggested that the definition of sales price for purposes of the retailers' and manufacturers' taxes be amended to include specifically compulsory charges for the warranty of the articles.

It is believed that the report accompanying such legislation should indicate that these amendments are declaratory of the intent of Congress as originally expressed in enacting section 6416 (b) (1) of the 1954 Code and the corresponding provisions of the 1939 Code and prior laws.

2. *Cooperative advertising.*—In 1932 the Service published a ruling holding that additional charges billed by a manufacturer to a distributor or dealer for advertising may be excluded from the selling price if it could be established that the value of the advertising service equaled or exceeded the amount so collected. These amounts could be excluded from the tax base only if they were shown separately on the invoices to the customer and were expended for local advertising. The ruling also provided that all national advertising is an expense to the manufacturer and must be borne by him.

In *F. W. Fitch Company* v. *United States* (323 U. S. 582 (1945)), the Court concluded that none of a manufacturer's advertising costs may be excluded in determining the sales price subject to tax.

The basic questions involved in treatment of cooperative advertising are:

(1) Whether such charges are initially includible in the manufacturer's sales price on which tax is to be based, or

(2) Whether, if such charges are initially includible, allowances for advertising expenditures constitute readjustment of the manufacturer's selling price for tax credit or refund purposes.

This problem depends upon whether the amount paid by a manufacturer's vendee for advertising purposes becomes the property of the manufacturer to hold or dispose of as he chooses. If so, such amount should be included in the basis of the tax. On the other hand, the advertising charge may represent a contribution by the customer to a fund which never becomes the property of the manufacturer, but remains the property of the customer or group of customers who contribute to the fund. In this situation, the advertising charge should not be a part of the manufacturer's tax base.

Based on the foregoing, the present position of the Service with respect to cooperative advertising substantially is as follows:

(1) The distinction between national and local advertising is abolished.

(2) Where a manufacturer's selling price to his customer contains an unsegregated advertising charge, it is a part of his tax base.

(3) In the case where a manufacturer makes a separate charge to his distributor for advertising and the proceeds are kept in a separate account earmarked for advertising, the separate advertising charge is not a part of the tax base. This exclusion of the advertising charge from the tax base can be supported by establishing that the charge is either listed separately on the sales invoice or billed separately; the contributions from distributors are set aside as a fund to be used for advertising for the benefit of these contributors; and the funds are so used or the unexpended portion is held in trust or refunded to the contributor upon his withdrawal from the program.

(4) Even in the case of a separate fund (as outlined in (3) above), where the manufacturer makes a contribution to the advertising account, then in accord with *Fitch* v. *U. S.*, *supra*, the amount of the manufacturer's contribution may not be deducted in computing the taxable sale price. However, subsequent allowances from such contributions to distributors for expenditures by them or their dealers in advertising are to be treated as readjustments of sale price under section 6416 (b) (1) of the Code.

The recognition of the allowances in the situation last described as readjustments of sale price is distinguishable from the issue involving the treatment of expenses incurred in fulfilling warranties on the ground that they constitute direct allowances by the manufacturer to his customer as a part of the sales program in which the manufacturer is involved. These adjustments are, as indicated before, made to the manufacturer's vendee and are not dependent upon conditions which may subsequently occur with respect to the article in the hands of the ultimate consumer many steps removed from the transaction upon which the imposition of tax occurred.

3. *Sale of installment accounts.*—Where an article subject to a retailers or manufacturers excise tax is sold by the manufacturer or retailer under an installment sales contract, only a part of the tax becomes due with each installment. The law provides (secs. 4053 and 4216) that the manufacturer or retailer is to pay a portion of the total tax upon each payment in the ratio that such payment bears to the total charge for the article.

There is no provision in present law setting forth how the tax is to be computed where installment accounts are sold or otherwise disposed of by the manufacturer or retailer. The Internal Revenue Service has taken the position that in such cases tax is to be computed on the face (unpaid) amount of the installment obligations disposed of, except in the case of a sale pursuant to a bankruptcy or receivership proceeding. In the latter case, the tax is computed on the amount realized on the disposition of the installment accounts. However, where a sale is made, the remainder of the tax immediately becomes due because the seller is no longer collecting his payment on an installment basis.

It is suggested that any uncertainty as to congressional intent be resolved by statute. The rule applied by the Service is proposed as being a reasonable one if the rule used for bankruptcy and receivership sales is extended to sales under any other legally distressed situations.

Maintenance of liability for tax in the full amount of the original sales price is suggested where installment accounts are sold under ordinary sales arrangements for several reasons. Since the customer receives no price or tax reduction as the result of the sale of his installment debt, the basis of the transaction giving rise to the tax liability has not changed. The manufacturer or retailer may sell the accounts at a discount, but this is his own business decision as to the value to him of a current smaller amount of money against future larger amounts. It might also be pointed out that a manufacturer or retailer who sells on a normal credit arrangement and is subsequently unable to collect is not relieved of liability for tax due. In the case of bankruptcy sales, etc., the amelioration suggested is in accord with the taxpayer's loss of control over his affairs and the general approach of granting relief in such cases.

4. *Installment accounts under Louisiana law.*—Sections 4053 and 4216 (c) of the 1954 Internal Revenue Code provide that if an article subject to retailers' or manufacturers' excise tax is (1) leased; (2) sold under a contract providing for payment of the sale price in installments with the seller retaining title to the article until full payment has been made; (3) sold on a conditional sale basis; or (4) sold under a chattel mortgage arrangement with the sale price to be paid in installments, the tax is to be paid on an installment basis proportionate to the total price represented by each payment.

Under the laws of Louisiana a seller may not retain title to the article until the sales price is fully paid and may not enter into a mortgage arrangement which would give him unrestricted rights of repossession if the purchaser fails to meet all his payments. Thus, if a purchaser in Louisiana disposes of the article and transfers possession to a third party before completing payments on his installment contract, the seller has no right to repossess the article in case the purchaser defaults in his obligations. However, Louisiana does recognize a contract which provides for payment of the sales price on an installment basis and gives the seller a lien on the article while still owned by or in the possession of, the purchaser which may be enforced in the event of default by appropriate court proceedings.

While this problem is now under consideration in the Revenue Service, there is a possibility that such an arrangement, although

recognized under Louisiana law as giving the seller a limited form of lien on the article, does not constitute a chattel mortgage arrangement within the contemplation of paragraph (4) of sections 4053 and 4216 (c) of the code and that the taxpayer in such case would be required to pay the tax in full during the return period in which the sale was made even though he would not receive his payments in full for some time. To make it clear that taxpayers in Louisiana are to have the privilege of deferring their tax payments under the installment type of contract with retention of lien which is recognized under Louisiana law, it is suggested that sections 4053 and 4216 (c) be appropriately amended to cover such types of contracts.

5. *Consolidated returns.*—Frequently small retailers and door-to-door salesmen are unwilling to handle articles subject to a retailers excise tax because of the problem of accounting for and making a return of the tax. This usually applies in the case of toilet preparations and jewelry. Moreover, in some cases, retailers who make only a few sales of such taxable articles and door-to-door salesmen fail to make returns. In order to obviate these difficulties, wholesalers and distributors of articles subject to the retailers excise tax have indicated a willingness to file returns in certain cases on behalf of small retailers or house-to-house canvassers who handle their products. Such a procedure would benefit small business men and would result in greater tax compliance, since the wholesaler or distributor is in a position to determine from his books and records the amount of sales of taxable articles.

In addition, independent truckers will often refuse to haul the products of shippers, such as dairies, coal companies, etc., since such service would require the trucker to collect and return the transportation of property tax on the charge made for the hauling. Since the tax here involved is imposed upon the person making the payment for the transportation service, shippers who engage truckers knowing that such truckers will not collect the tax expose themselves not only to direct assessment of the tax due with respect to the taxable payment but also to the addition of civil penalties for wilfully failing to pay the tax known by them to be due. In order to have readily available the services of these truckers, shippers have requested permission to file returns and pay tax on behalf of such truckers upon whom the law vests the obligation to collect and return the tax.

It is suggested, therefore, that the code be amended to provide that the Secretary or his delegate may authorize by regulations, and subject to such limitations and conditions as appear appropriate or administratively desirable, that a person liable for the filing of returns of retailers taxes and the transportation of property tax may by power of attorney designate his supplier or shipper to perform such acts as are required of him in connection with the filing of returns relating to such taxes. It should be further provided that all applicable provisions of law (including penalties) should be applicable to the agent or the person so designated, but the retailer or shipper for whom such agent or other person acts would remain subject to the provisions of law (including penalties) applicable to them. Such a provision would be generally comparable to section 3504 of the code which permits employers of persons covered by the employment tax provisions to designate fiduciaries, agents, or other persons who pay the wages of an employee or group of employees of such employer to file returns on behalf of the employer.

II. MANUFACTURERS' EXCISES

A. Full agreement

1. *Rebuilt automotive parts.*—The sale of automotive parts and accessories by the manufacturer is taxed under section 4061 (b) of the code. Regulation 46 provide that any person who produces a taxable article from scrap, salvage, or junk material, as well as from new or raw material, (1) by processing, manipulating, or changing the form of an article, or (2) by combining or assembling two or more articles, is a "manufacturer" for purposes of the law.

It has been a long-established position of the Service that the sale of rebuilt articles subject to the manufacturers' excises incurs liability for the taxes imposed. The conclusion of the Service that rebuilding constitutes manufacturing and that the sale of rebuilt parts is taxable has been sustained by the courts (*Clawson and Bals, Inc.*, v. *United States*, 182 F. 2d 402, cert. denied, 340 U. S. 883; *Armature Exchange, Inc.*, v. *United States*, 116 F. 2d 969, cert. denied, 313 U. S. 573)

S. T. 927 (C. B. 1942–2, p. 225) outlined in general the circumstances under which a person may be regarded as a manufacturer as to articles which may have been rebuilt, repaired, or otherwise restored to usefulness.

The Service later published S. T. 932 (C. B. 1945, 431) more specifically relating to the rebuilding or reconditioning of automobile parts or accessories. There it was held that the mere disassembling, cleaning and reassembling performed in reconditioning used automobile fuel pumps, water pumps, carburetors, distributors, shock absorbers, windshield wiper motors, brakeshoes, clutch disks, voltage regulators, etc. do not incur manufacturers' excise tax regardless of by whom performed.

The manufacturers' excise tax applies to the rebuilder's sale from his stock on hand of (*a*) rebuilt batteries, (*b*) rebabbited or machined connecting rods, (*c*) rebuilt clutch assemblies, (*d*) resurfaced clutch plates, (*e*) rewound armatures, (*f*) reassembled generators containing armatures rewound by the reassembler, (*g*) remetalized crankshafts, (*h*) motors in which the cylinders are machined, (*i*) shock absorbers in which some of the parts are machined, and (*j*) similar items in which machining, rewinding, or comparable operations are performed.

The ruling further distinguishes between situations involving persons engaged in the business of rebuilding and mere repairmen, i. e. whether the person rendering the service was doing so on a custom basis with title remaining in the customer for whom the job was being done or regularly engaged in the rebuilding of articles for resale.

In 1954 the Service published a ruling superseding S. T. 932 holding that a "manufacturer" is further defined as a person engaged in the production of rebuilt auto parts or accessories for sale or for use in further manufacture of other articles for sale. The terms "reconditioning," "rebuilding," and "repairing," were not to be considered synonymously. Each refers to a separate and distinct operation. The conclusions of the Internal Revenue Service as to what is comprised within each operation and the taxable consequences are as follows:

> (*a*) *Reconditioning.*—The mere disassembling, cleaning, and reassembling of used automobile fuel pumps, water pumps, carburetors, distributors, shock absorbers, windshield-wiper motors,

brakeshoes, clutch disks, voltage regulators, and so forth, are regarded as reconditioning operations distinct from the manufacture or production of rebuilt articles. The sale or use of such reconditioned parts is not taxable, regardless of who performs the reconditioning operations.

(*b*) *Rebuilding.*—Reboring or other machining, rewinding, and comparable major operations performed on used parts being processed for sale or for use as components of other articles for sale are defined as rebuilding operations constituting manufacture for purposes of the tax. The person owning parts being rebuilt for such disposition is the rebuilder (manufacturer) and is liable for the tax on his sales of the rebuilt parts. The tax applies whether the machining, and so forth, operations are performed by the rebuilder himself or by some other person in his behalf.

The manufacturers' excise tax was held to apply to the rebuilder's sale of (*a*) rebuilt batteries, (*b*) rebabbitted, or machined connecting rods, (*c*) resurfaced clutch plates, (*d*) rewound armatures, (*e*) reground or remetalized crankshafts, (*f*) engines in which blocks are machined (e. g., cylinders rebored, new sleeves inserted, with or without cylinders being rebored), or new blocks installed, and (*g*) similar parts on which machining, rewinding, or comparable operations are performed.

(*c*) *Repairing.*—The restoration of an owner's part to usable condition (but not for purposes of sale or for use as a component of other articles for sale) constitutes a repair operation whether performed by the owner himself or by others acting in his behalf.

Representations were made to the Service that in restoring used generators, the only processing involved was the rewinding of the armature and that the balance of the generator was merely disassembled and cleaned. Upon reassembly the rewound armature would then be slipped and fastened into the rest of the generator. Thus, it developed that where a rebuilder performed all of the operations necessary to the useful restoration of the generator in his own shop he was paying a tax based upon his net sale price of the rebuilt generator. If a different operator took in a used generator and sent out the armature to another shop to be rewound, the tax on that transaction was applied only to the amount charged by the rewinder for his operations or sale price of the rewound armature. This price was, of course, considerably less than the price charged by the rebuilder who completely processed a used generator.

As a result of this problem, the Service later published a ruling holding that in the reconditioning of a used generator which requires the replacement of the armature with one that has been rewound by the person restoring the generator to useful condition for sale, the manufacturing or rebuilding operation is performed on the armature only and the tax is computed on the established selling price of the armature component.

This latest position of the Service has been cited by taxpayers to support a conclusion that similarly the only manufacturing or rebuilding operation involved in restoring an automobile engine to useful condition is confined to the actual machining operations of those components of the engine requiring such physical processing. The Service has resisted adoption of this theory on the ground that in rebuilding an automobile engine the necessary operations involving

machining of connecting rods, regrinding of crankshafts, reboring of cylinders, and so forth, are all done as one operation and that the individual manufacturing operations are not as a practical matter farmed out. As a matter of fact, most engine rebuilding today of any consequence is being done on assembly-line basis comparable to the manufacture of new engines.

It is understood that the Service will reexamine its latest published ruling on the question of used generators to determine its reality in the light of the general tests established as to what constitutes rebuilding. The basis for this reexamination will be to determine whether in the case of restoring used generators, the disassembling of the generator and its integral parts, the rewinding of the armature, the reconditioning of the balance of the generator, and the reassembling of the completely restored generator constitutes in fact a complete rebuilding operation and, therefore, manufacture. Such a conclusion would then be consistent with the situation as applied to the rebuilding of engines.

2. *Electric direct motor-driven fans and air circulators.*—There is presently imposed a 5-percent excise on an extensive list of electric, gas and oil appliances. In the case of 21 appliances or groups of appliances, the articles must be of the household type before a tax is imposed. However, electric direct motor-driven fans and air circulators are taxed unless they are of the industrial type.

The Internal Revenue Service has interpreted the phrase "not of the industrial type" as meaning that the tax applies not only to fans and air circulators of the household type, but also of the type used in stores, offices, restaurants, and similar places. However, in practice it has been found that the fans and air circulators commonly used in commercial establishments are also used extensively in industrial establishments. Thus, it appears that in practice fans and air circulators are either of the household type or of the industrial type and that there is no intermediate classification.

To clarify the law and to provide a uniform rule, it is suggested that electric direct motor-driven fans and air circulators be taxed only if they are of the household type. Furthermore, it is believed that this will result in improved administration and better understanding of the law on the part of both the Service and the industry.

It appears that no revenue loss will result from this change.

3. *Definition of radio and television components.*—Public Law 367, 84th Congress, amended section 4141 which imposes a tax on radio and television sets, components therefore, phonographs and records, to provide that except in the case of radio and television components and phonograph records the tax imposed by section 4141 is to apply only to articles of the "entertainment type." Section 4142, which defines radio and television components, was not changed by Public Law 367. This latter section provides that the term "radio and television components" means certain parts, and so forth, "which are suitable for use on or in connection with, or as component parts of any of the articles enumerated in section 4141, whether or not primarily adapted for such use."

The above two sections appear contradictory. The sentence added to section 4141 by Public Law 367 appears to provide that radio and television components are taxable whether or not they are of the entertainment type, while the sentence in section 4142 defining

these components in effect appears to state that only those which are suitable for use on or in connection with entertainment-type articles are taxable. It can, of course, be argued that "commercial" sets, as well as those of the entertainment type, are "enumerated" in section 4141 even though no tax is imposed with respect to them.

It is suggested that the tax on television and radio components be clarified, and that it be applied only to those components which are suitable for use on or in connection with entertainment-type sets. This method of clarifying this problem is suggested because it appears inconsistent to limit the tax on radio and television sets to those of the entertainment type without imposing a similar limitation on parts. Moreover, limiting the tax on these components in this manner would make it necessary to determine only what constitutes entertainment-type radio and television receiving sets. It would not then also be necessary to determine what constitutes other types of television and radio sets in order to know what components are taxable.

It is estimated that the revenue loss under this provision will be very small.

B. Agreement in principle

1. *Leases.*—Sections 4053 and 4216 of the Internal Revenue Code of 1954 deal with the definition of price upon which retailers and manufacturers are required to pay the taxes imposed upon their sales. These sections provide that in the case of a lease of an article there is to be paid upon each payment with respect to the article that portion of the total tax which is proportionate to the portion of the total amount to be paid represented by such payment.

It has been held by the Service that each lease payment is taxable at the applicable rate, notwithstanding that the total of payments under the original and subsequent leases may exceed the price for which the retailer or manufacturer sold like articles in the ordinary course of business. This has given rise to protests by taxpayers to the effect that this result was inequitable and discriminatory.

In Public Law 317, 84th Congress, 1st session, the Congress recognized this situation and enacted an amendment to section 4216 providing that in the case of leases of trailers or semitrailers suitable for use in connection with passenger automobiles, a limited total tax was to be paid based upon the fair market value of the trailer on the date of the initial lease. It was further provided that the tax could be paid upon each lease payment equal to the rate of tax which would be imposed on the sale of the trailer or semitrailer until the total of the tax payments under the lease and any prior lease equaled the total tax. Appropriate adjustments were also provided for in case a leased article was sold prior to the time the total tax had been paid.

The principal of a limited tax on leased articles equivalent to the tax that would have been due if the article had been sold when new seems reasonable. Otherwise, the law acts to penalize competing methods of doing business. However, where the manufacturer (or retailer) never sells a given type of article, a limited total tax has little justification. In such cases the lessor has no fair market price upon which to compute a total tax and has deliberately decided not to compete on the same basis with those making outright sales.

If a change of this type were adopted, experience with Public Law 317 suggests that administration and compliance could be eased by

providing that the tax due on articles under lease on the effective date of the change be computed on the basis of the value of the article on the effective date as shown on the books of the lessor rather than the fair market value on such date.

While the Treasury Department agrees in principle with a limited total tax provision for leased articles, it does not suggest current action on this problem because it is anticipated that a relatively significant revenue loss would be involved.

III. RETAIL EXCISES

A. Full agreement

1. *Semiprecious stones purchased by lapidarists.*—Section 4001 of the Internal Revenue Code imposes a 10-percent retail excise on jewelry. For the purposes of the tax, pearls, precious and semiprecious stones, and imitations thereof are considered as jewelry. These statutory terms have created certain definitional problems in the enforcement of the tax.

In earlier years consumers bought gems only in finished form and not in a rough state. However, the growth of the lapidary and mineral hobbies have created a new industry in the gem field which has created a demand for different minerals and other raw material to pursue their hobbies. The problem which arises is how to determine which stones are taxable when the stones are still in their natural state. The difficulty is in determining the quality of the material from the point of view of hardness or gem quality.

The Internal Revenue Service has ruled that the tax imposed by section 4001 does not apply to mineral substances or varieties not commonly and commercially known as precious or semiprecious stones, or, to stones which are of an inferior quality and unsuitable for cutting and polishing into gems when such substances are in the natural state or especially designed as specimens for display of the material. In addition, the Internal Revenue Service has ruled that rough gem material 6 or more in hardness on the Mohs' scale is taxable with various exceptions for softer stones and has relied in determining what stones are commonly and commercially known as precious or semiprecious upon commonly accepted reference works in the field.

However, hobbyists collect, cut, and polish whatever stones which strike their fancy, and suppliers, to keep pace with their customers' desires, make available for sale the varieties of stones in demand. As a result, a piece of material offered for sale by a supplier will often give rise to a number of difficult problems. For example, it must be determined if the stone qualifies as one which is precious or semiprecious. In determining whether or not the material is gem quality it may measure in the Mohs' scale in hardness from 5½ to 6 in various places on the same piece. Moreover, whether or not a stone is suitable for cutting and polishing into gems may be determined only after it is cut and polished. By the same token, it may be difficult, or even impossible, to judge its quality until it is cut or polished.

Because of the difficulty of these questions and the different definitional problems arising from the nature of the material subject to the tax, it is suggested that a test be supplied in the statute which will render, insofar as is possible, certainty for both the Internal Revenue

Service and the persons subject to the tax. Accordingly, it is proposed that in the case of semiprecious stones the test of taxability be made to turn upon the finished state of the stone, and that no semiprecious stone which has not been cut or polished be subject to the tax. This proposal contemplates that existing law and practice be retained but that an additional test be added in the case of semiprecious stones to the effect that they are taxable only when they are cut or polished. It is believed that the proposed test will furnish both those charged with the duty of administering the tax and those subject to it a more certain standard by which the taxability of a given piece of material can be determined.

2. *"Basket" clause under luggage tax.*—Section 4031 imposes an excise tax on the retail sale of luggage. Eighteen separate items are specifically named as subject to this tax. The section also contains a provision which subjects to tax "Other cases, bags, and kits (without regard to size, shape, construction, or material from which made) for use in carrying toilet articles or articles of wearing apparel." This "basket" clause subjects articles to tax which are not specifically named in the section but which are determined to be cases, bags, and kits "for use in carrying toilet articles or articles of wearing apparel."

This clause is indefinite, and retailers are not always sure which articles are subject to luggage tax. An article which may have a use in carrying wearing apparel may also be used, or be suitable for use, equally well for other purposes. In such case, if the article is sold in the luggage department of a retail establishment and held out, as provided in section 4031, "for use in carrying wearing apparel," it is subject to tax. On the other hand, if the same article is sold in a nonluggage department of a retail establishment and held out for a nontaxable use, there would be no tax on the sale of the article.

It is realized that cases, bags, and kits which are in general use for carrying toilet articles or articles of wearing apparel are varied and that new ones are constantly being introduced. This makes it impossible to provide as much certainty as might be desired. However, much more certainty can be provided by removing the basket clause. Thus it is suggested that this provision be removed from section 4031 and that in lieu thereof a somewhat longer list of articles be subjected to tax. Such a list might include the following articles:

Bathing suit bags
Beach bags or kits
Billfolds
Briefcases of leather or imitation leather
Brief bags
Camping bags
Card and pass cases
Carryall bags
Carrying kits
Collar cases
Cosmetic bags and kits
Dressing cases
Duffelbags
Furlough bags
Garment bags designed for traveling
Hatboxes for use by travelers
Haversacks
Key cases or containers
Knapsacks
Knitting or shopping bags (suitable for use as purses or handbags)

Makeup boxes
Manicure set cases
Memorandum pad cases[1] (suitable for use as pass cases, billfolds, purses, or wallets)
Musette bags
Pocketbooks
Purses and handbags
Ring binders, capable of closure on all sides, of leather or imitation leather
Salesmen's sample or display cases, bags or trunks
Satchels
Shoe and slipper bags
Suitcases
Toilet kits and cases
Tote bags
Traveling bags
Trunks
Vanity bags or cases
Valises
Wallets
Wardrobe cases

IV. EXCISES ON FACILITIES AND SERVICES

A. Full agreement

1. *Geographical scope of the general admissions tax.*—The tax on general admissions imposed by section 4231 (1) is levied on "the amount paid for admission to any place." However, the law does not indicate whether the admission or the payment therefor, or both, must take place within the United States. This has created an area of uncertainty, especially in sections near the borders of the United States. There tickets may be purchased in the United States for events which are to take place outside the United States, and vice versa.

To resolve this uncertainty, it is suggested that the law definitely state the geographic area to which the admissions tax applies. The rule suggested is to make the tax applicable to admissions only when the events take place in the United States. Thus, persons purchasing tickets inside the United States for events outside the United States would be treated as if they had purchased the tickets upon entrance to the event rather than beforehand.

Acceptance of the rule suggested should not place additional burdens upon proprietors of taxable events in the United States. The regulations now require printing of the established price and the tax thereon on tickets to taxable events and the collection and remission of such tax by the proprietor. Where tickets are sold to a domestic event in a foreign country, by a branch office or agent of the domestic proprietor, the latter would merely require the tax to be reflected in the price as in the case of sales at the box office. The proprietor then would be liable for turning over the tax to the Government in the usual manner.

2. *Exclusive use of cabaret premises.*—As evidenced by the testimony before this subcommittee and correspondence introduced into the record, considerable confusion exist in taxpayers minds concerning the application of the cabaret tax imposed by section 4231 (6) of the Internal Revenue Code of 1954 to private affairs conducted by organizations in cabarets.

Section 4231 (6) imposes an excise equivalent to 20 percent of all amounts paid for admissions, refreshment, service, or merchandise at any roofgarden, cabaret, or other similar place furnishing a public

[1] If suitable for use as pass cases, billfolds, purses, or wallets.

performance for profit by or for any patron or guest who is entitled to be present during any portion of such performance. Ballrooms or dancehalls where the serving or selling of food, refreshment, or merchandise is merely incidental are explicitly excluded from the definition of cabaret by section 4232 (b). The same subsection specifically excludes mere instrumental or mechanical music from the definition of entertainment. Section 4232 (c) provides that a performance shall be regarded as being furnished for profit even though the charge made for admission, refreshment, service, or merchandise is not increased by reason of the furnishing of such performance.

The application of the cabaret tax to affairs conducted by private organizations on premises which are regularly employed as cabarets subject to the tax may be illustrated by the following two extreme factual situations:

a. A room which is customarily utilized as a cabaret is rented on a particular night to a private organization for the purpose of holding a dinner and providing entertainment. The affair is in the complete control of the organization as is the sale of tickets and members of the general public are not admitted. The proprietor furnishes the dinner to the organization. In addition the same entertainers who regularly perform in that room on other nights are furnished to provide entertainment. In this situation, the Internal Revenue Service has ruled that the arrangements made by the private organization are to be regarded as a mere reservation of tables and the cabaret tax is to apply to the payment made by the private organization to the proprietor and to all amounts paid for refreshment, service, and merchandise. However, under such circumstances no cabaret tax attaches to the amounts paid to the private organization for tickets to the affair nor is any admissions tax.

b. Where a room, which is not customarily utilized as a cabaret, is rented to a private organization for the purpose of holding a dinner and providing entertainment, and the private organization has complete control of the sale of the tickets for the affair and members of the general public are not admitted, the Internal Revenue Service has ruled that the cabaret tax is not applicable to the affair even though the proprietor furnishes the dinner to the organization in addition to entertainment provided by entertainers who may be performing regularly in another room on the premises. However, if the organization makes a fixed charge to persons attending the affair which is in excess of the charge made by the proprietor for the dinner, that part of the charge which is in excess of the charge made for the dinner is subject to the admissions tax imposed by section 4231 (1) of the Internal Revenue Code of 1954.

The foregoing rule is also applied where the organization makes its own independent arrangements for entertainment.

While the two foregoing examples are clear enough and the results generally accepted by taxpayers, difficulties arise administering the cabaret tax when these factual situations begin to vary in degree. For example, where a room which is customarily utilized as a cabaret is rented to an organization for the conduct of a private affair and the organization contracts with the proprietor for the dinner and negotiates for the entertainment regularly performed in that room on nights when the room is open to the general public and as a result of such negotiations pays a pro rata portion of the fee regularly

received by such entertainers directly to the proprietor, the Internal Revenue Service has ruled that the cabaret tax does not apply (although the admissions tax may). On the other hand, because of the terms of the statute, the Internal Revenue Service has been forced to rule that the cabaret tax is applicable in the same situation where the facts indicate that the organization has made a flat payment to the proprietor to cover the dinner and regularly employed entertainment even though the organization provides some additional entertainment of its own.

In order to remove the existing uncertainties and to provide a definite rule for the convenience of both taxpayers and those charged with enforcing the cabaret tax, it is proposed that the Internal Revenue Service reexamine its rulings in this area and issue new rulings to provide that where a private organization conducts an affair in a room customarily and regularly used as a cabaret to which the tax applies and negotiates with the proprietor to provide the dinner and any other services desired, but not for the entertainment, the cabaret tax will not apply if the private organization by independent negotiations provides its own entertainment, the entertainers are not regularly employed by the proprietor in the room and are different individuals from those employed in the room both prior to and after the affair in question. It is believed that this proposal will eliminate the existing confusion in the field and provide a rule which will be certain in its application and easily understood not only by taxpayers but by those charged with the duty of enforcing the cabaret tax in the field.

The foregoing proposal would require that the Internal Revenue Service review the ruling which has in the past permitted private organizations to escape the cabaret tax where the entertainment provided at such affairs is that regularly employed in the room and a pro rata proportion of the regularly charged fee for entertainment is paid to the proprietor on behalf of the entertainment.

3. *Collection of tax on amounts paid to concessionaires at cabarets.*—The cabaret tax is levied upon—

> * * * all amounts paid for admission, refreshment, service, or merchandise, at any roofgarden, cabaret or other similar place * * *.

It is not unusual for proprietors of cabarets to sell or lease concessions to other persons who sell refreshments, service, or merchandise to the patrons of the cabaret, but the payments the concessionaires receive are often not reflected in the books of the proprietor nor does the concessionaire always file returns and pay tax upon the amounts he receives as payment for his refreshment, service, or merchandise. In addition, concessionaires change frequently so that locating them for the purposes of tax collection is difficult.

To assure the payment of the tax and the availability for tax determination of a more readily identifiable person, consideration should be given to providing that the proprietor, owner or lessee of a cabaret is to collect the cabaret tax from the concessionaires and include such amounts in making monthly deposits and quarterly returns with respect to his tax liability on other payments received by such proprietor, owner or lessee for admission, refreshment, service, or merchandise. The proprietor, owner, or lessee would be subject to all of the provisions of law now applicable with respect to persons liable for the collection and payment of taxes on admissions as regards the tax liability of the concessionaires in his cabaret.

4. *Life memberships in social clubs.*—The tax on dues to social clubs imposed by section 4241 requires that in the case of life memberships an annual tax shall be paid equivalent to the tax upon the amount paid by active resident annual members for dues or membership fees other than assessments. In practice, this means, in most cases, a tax on the highest annual rate of dues. No tax is levied upon the payment as such for the life membership.

The present system may result in the long run in a tax bearing no relationship to the amount paid for the life membership, or the value of its perquisites if, as in some cases, it is an honorary or free life membership.

It is suggested that the annual tax on life memberships be equivalent to the tax on the annual dues and membership fees of the type of annual membership providing privileges most nearly like that of the life membership. This would provide tax relief in those cases where the life membership provided privileges of a limited nature compared to those of an active resident member.

5. *Communications taxes.*—The Treasury and Joint Committee staffs at this time are not able to make any joint recommendations in the area of the communications taxes. A large amount of valuable material bearing on possible changes in these taxes has been received only quite recently, and it has not been possible as yet to adequately examine the suggestions.

The staffs agree that, if possible, it would be desirable to revise substantially the basis of these taxes in order to simplify and consolidate them, to bring them more in line with technical advances which have occurred in recent years, and to remove competitive problems which have developed since these taxes were last reviewed.

If it meets with the subcommittee's approval, the staffs will set a joint group to study these taxes and report back later this year.

V. DOCUMENTARY STAMP TAXES

A. Full agreement

1. *Partnership treatment.*—Section 4352 of the Internal Revenue Code provides in the case of the transfer of an interest in a partnership which holds any stock, stock rights, or certificates of indebtedness that the taxes on the transfer of these instruments are to apply to the same proportion of these instruments held by the partnership as the interest in the partnership being transferred bears to the interests of all of the partners. This in effect provides that when an interest in a partnership is transferred, any underlying securities held by the partnership, to the extent of the share represented by the transferred interest, are also considered as being transferred. This follows the so-called "aggregate" rule and in effect treats each partner as if he held separately his pro rata share of all partnership property.

However, courts have held under New York partnership law, which generally follows the Uniform Partnership Act, that no stamp tax may be imposed upon the adjustment of a partnership interest. (See *Salomon Brothers & Hutzler* v. *Pedrick*, 105 F. Supp. 210 (1952).) The so-called "entity" theory of partnerships has been held to apply, and as a result it has been concluded that adjustments of the interests of the partners do not result in transfers of the underlying partnership property. The "entity" rule, for the most part, is also the standard

rule adopted in the income tax partnership provisions under the 1954 code.

To assure uniform treatment among the various States, and also to conform the documentary stamp provisions relating to partnerships with those under the income tax, it is suggested that the so-called "entity" rule be adopted for transfers of partnership interests in the case of the documentary stamp taxes.

The adoption of the "entity" rule generally would mean that stock and bond transfer taxes and real estate conveyance taxes would not be imposed with respect to:

(1) An adjustment of the interests of the partners,
(2) The sale or other disposition by a partner of his interest,
(3) The death or retirement of a partner,
(4) The admission of a new partner, and
(5) The liquidation of a partner's interest.

However, in any of the above cases where stocks, bonds, or real estate held by the partnership are distributed to a partner in either a current or liquidating distribution or are sold to a partner, a transfer or conveyance tax would be imposed. The tax would be imposed in these cases because the stock, bond, or real estate itself was being transferred and not merely an interest in a partnership. Of course, transfer or conveyance taxes would be imposed where a partnership is considered as being "terminated" under the income tax rules provided in section 708 (b) and a newly formed partnership continues to use the property held by the former partnership. This would be true because in such a case the property would be considered as distributed and then recontributed. A transfer or conveyance tax would also continue to be imposed where the partnership itself sold or otherwise transferred the property in question.

It is estimated that this proposed change will result in only a very small revenue loss.

2. *Payment of transfer taxes through a national securities exchange by check.*—Regulations 71 issued in 1943 provide that a member of a national securities exchange can appoint the clearinghouse of the exchange as his agent for purpose of affixing the stamps required on his stock and bond transactions. The member-broker is required to file a daily report with the clearinghouse showing the total tax payable on all of his transactions (whether or not through such exchange). He also must maintain detailed books of all of his stock transactions showing the tax payable. The clearinghouse, however, purchases and affixes to a summary sheet covering all of the reports it receives from brokers sufficient stamps to cover all of the transactions for the reporting brokers. The broker indicates by a stamped endorsement on the stock certificate, or accompanying memorandum of sale, that the transfer tax has been paid through the clearinghouse. Agents of the Internal Revenue Service check the proper payment of taxes by comparing the daily report with the brokers' books and the canceled stamps retained by the clearinghouse.

While this method of tax payment in the case of national security exchange members has been generally approved, it still contains a useless step, namely, the purchase and cancellation of tax stamps. It has been pointed out that this method requires the daily purchase of stamps in large amounts, the individual canceling of these stamps, and their storage in safekeeping for several years awaiting audit.

In the interest of simplifying administration and easing taxpayer compliance, it is suggested that the purchases of stamps by clearinghouses of national security exchanges no longer be required and instead that the clearinghouses be required to make daily payment by check to an authorized Government depository of the total amount of taxes shown on the broker-members' reports. A system similar to this has been in effect in New York State since 1943.

3. *Exemption certificates.*—Section 4344 provides that no exemptions be granted from the documentary-stamp tax in certain cases unless the delivery or transfer of the document qualifying for exemption is accompanied by a certificate setting forth such facts as the Secretary or his delegate may by regulations prescribe.

This requirement as to exemption certificates exists in the case of most, but not all, of the exemptions under the various documentary-stamp taxes. For example, it applies in the case of the exemptions for delivery of stock or certificates of indebtedness to a borrower as a loan of the shares or certificates (or to the lender as a return of the loan), to brokers (or their registered nominees) for sale or from brokers to their customers, and from a corporation to a registered nominee of the corporation (or from one nominee of a corporation to another). It does not, however, apply in the case of transfers from an executor or an administrator to a legatee, heir or trustee where the value of the stock is not greater than the tax that otherwise would have been imposed. Also, the exemption certificate requirement is not applied in the case of delivery of stock or certificates of indebtedness to a lender as collateral security but does apply where the delivery or transfer is to a trustee or public officer as security for the performance of an obligation.

It is suggested that the statutory requirement for exemption certificates under the documentary-stamp tax be liberalized. This will constitute a simplification as far as taxpayers are concerned since proof will not be required where the basis for the exemption is obvious as a result of the nature of the transaction. The Secretary will, however, under his general regulatory authority still be able to require proof that the taxpayer is eligible for the exemption where that appears appropriate. With the liberalization of this provision, this need not, even in these cases, however, take the form of an exemption certificate.

4. *Return of stock or certificates of indebtedness depositied as collateral security*—Section 4341 (1) provides an exemption from the documentary-stamp tax on transfers of stock or certificates of indebtedness which have been deposited as collateral security for money loaned (if the collateral security is not sold). However, this section provides no exemption when the collateral is returned to the borrower of the money upon repayment of the loan. In this respect this provision differs from the exemption provided in section 4341 (2), relating to delivery to a trustee or public officer as a performance security, where a specific exemption is provided for the return of the stock or certificate. The regulations on the collateral security provision exempt the return of the stock or certificates or indebtedness from the transfer tax when the loan is paid.

It is suggested that the statute be amended to specificially exempt from the transfer tax the return of stock or certificates of indebtedness in such cases. This is intended to be declaratory of existing law.

5. *Basing the stock issuance and transfer taxes on the actual value rather than par value.*—Section 4301 imposes a stamp tax on the original issue of stock. The rates under the issuance tax are 11 cents per $100 (or fraction thereof) of the par or face value of the certificate (or shares if no certificate is issued). In the case of no par value stock, the tax is 11 cents on each $100 (or fraction thereof) of the actual value of each certificate (or shares where no certificate is issued) except that where the actual value is less than $100 per share, the tax is 3 cents on each $20 (or fraction thereof) of the actual value of each certificate (or share).

Section 4321 imposes a stamp tax on the transfer of shares or certificates of stock or stock rights. The rate in this case for par value stock is 6 cents on each $100 (or fraction thereof) of the par or face value of each certificate (or share if no certificate is transferred), or if the stock is sold for less than $20 per share the rate is 5 cents. In the case of no par value stock selling for more than $20 per share, the tax is 6 cents per share and for stock selling below this price the tax is 5 cents per share.

It is difficult to justify the imposition of either the stock transfer or issuance taxes on the basis of par value. Par value has no real or economic meaning and, in fact, is often adjusted to incur the smallest possible amounts of issuance and transfer taxes. Moreover, the present treatment wherein no par value stock is taxed on a per share basis (or actual value basis in the case of the issuance tax) has meant in general that those stocks which do not maintain the fiction of a par value are subject to a much heavier transfer tax than those having a par value, since a relatively low par value usually is taken.

The present system which is based in large part on par value is undesirable because it creates distinctions between stocks on an artificial basis which have no relationship to the value of the stock. Moreover, the present arrangement tends to discriminate against stocks of a relatively low value since such stocks are likely to have at least as high a par value as higher priced stocks. The artificiality of the present par value system is illustrated in table 1 which shows the impact of the present Federal stock transfer tax during November 1955, on the 100 most active stocks listed on the New York Stock Exchange. This table for comparative purposes also shows what the tax would have been per share in the case of these stocks if it had been computed at a rate of 5 cents per $100 of market value. This table illustrates quite clearly that under the present tax there is no consistency whatever between the price of the stock and the transfer tax payable.

It is suggested that the stock, transfer, and issuance taxes be revised as follows:

(*a*) The tax on the transfer of stock or stock rights would, in general, be 5 cents on each $100 or major fraction thereof of the *actual value* of each certificate (or of the share where no certificate is transferred). The minimum tax per certificate (or per share where no certificate is issued), would be 5 cents per transaction. In the case of transfers which do not involve a sale or exchange for value, the rate would be 5 cents per share.

(*b*) In the case of the stock issuance tax, the rate would be 10 cents on each $100 or major fraction thereof of the *actual value* of each

certificate (or of the shares where no certificate is issued). The minimum tax in any case would be 10 cents per certificate (or share if no certificate is issued).

The transfer tax constitutes the principal source of revenue in this area and is the tax on which certain sampling was obtained to determine the rate which should be imposed to maintain current revenues. Based upon an examination of the transfers which occurred on the New York Stock Exchange in November 1955, it was found that, based upon the then current price level, a tax of 4 cents per $100 of market value would result in approximately the same revenue collections as the present par value taxes. However, it is recognized that this is a period of historically high values for most stocks, and for that reason it is believed necessary to impose a rate of 5 cents per $100 of actual value if current revenues from these taxes are to be maintained. The rate of 10 cents per $100 of actual value in the case of the stock issuance tax maintains approximately the same relationship between this tax and the transfer tax as exists at present.

TABLE 1.—*Impact of Federal stock transfer taxes on 100 most active stocks listed on the New York Stock Exchange, November 1955*

Issue	Average price	Par value	Federal stock transfer tax per 100 shares	
			Actual tax	Tax if computed at 5 cents per $100 of market value
Benguet Consolidated Mining	$1.38	$9	$0.45	$0.05
Graham-Paige Corp	1.94	No	5.00	.10
Electrical & Musical Industry	3.56	1⅔	.07	.20
Avco Manufacturing Corp	5.94	3	.15	.30
Rhodesian Selection Trust	6.63	7/10	.035	.35
Alleghany Corp	8.75	1	.05	.45
Studebaker-Packard	10.38	10	.50	.50
Panhandle Oil Corp	12.56	1	.05	.65
Wilson & Co	13.13	No	5.00	.65
Fairchild Engine & Airplane	13.38	1	.05	.65
Baldwin-Lima-Hamilton	14.13	13	.65	.70
Braniff Airways	14.56	2½	.125	.75
Libby-McNeill-Libby	14.69	7	.35	.75
Lehigh Coal & Navigation	14.88	10	.50	.75
J. I. Case	15.06	12½	.625	.75
Armour & Co	15.44	5	.25	.75
Columbia Gas System	16.06	No	5.00	.80
Burlington Industries	16.69	100	5.00	.85
Raytheon Manufacturing	16.69	5	.25	.85
Pan-American World Airways	17.63	1	.05	.90
Penn-Texas Corp	19.00	10	.50	.95
Southern Co	19.19	5	.25	.95
United Merchants & Manufacturers	19.63	1	.05	1.00
Celanese Corp	19.88	No	5.00	1.00
National Distillers	20.06	5	.30	1.00
Loew's	20.38	No	6.00	1.00
Budd Co	20.81	5	.30	1.05
Western Union	21.44	2½	.15	1.05
Pepsi-Cola	22.56	⅓	.02	1.15
National Container	23.25	1	.06	1.15
Chicago Corp	23.38	1	.06	1.15
Sperry-Rand Corp	23.38	½	.03	1.15
American Airlines	23.44	1	.06	1.15
Sunray-Mid-Continent	23.63	1	.06	1.20
Merritt-Chapman & Scott	23.75	12½	.75	1.20
Merck & Co	24.13	⅙	.01	1.20
Chicago, Milwaukee, St. Paul	25.63	No	6.00	1.30
Pennsylvania RR	25.88	50	3.00	1.30
Curtiss-Wright Corp	27.63	1	.06	1.40
International Telephone & Telegraph	28.06	No	6.00	1.40
TXL Oil Corp	28.38	1	.06	1.40
Monterey Oil Co	29.69	1	.06	1.50
International Minerals	30.13	5	.30	1.50
Fairbanks, Morse & Co	30.94	No	6.00	1.55

TABLE 1.—*Impact of Federal stock transfer taxes on 100 most active stocks listed on the New York Stock Exchange, November 1955*—Continued

Issue	Average price	Par value	Federal stock transfer tax per 100 shares	
			Actual tax	Tax if computed at 5 cents per $100 of market value
United Dye & Chemical	$31.00	$1	$0.06	$1.55
Colorado Fuel & Iron	31.13	No	6.00	1.55
Glenn L. Martin	31.94	1	.06	1.60
Canadian Pacific Ry	32.38	25	1.50	1.60
Niagara Mohawk Power	32.50	No	6.00	1.60
Ohio Oil Co	33.19	No	6.00	1.65
Chance Vought Aircraft	35.06	1	.06	1.75
Texas Pacific Coal & Oil	35.13	10	.60	1.75
Pittston Co	35.25	1	.06	1.75
International Harvester	36.00	No	6.00	1.80
Atlantic Refining	36.31	10	.60	1.80
Texas Gulf Sulphur	37.75	No	6.00	1.90
Sears, Roebuck (new)	38.81	3	.18	1.95
Texas Gulf Producing	40.00	3⅓	.20	2.00
Schering Corp	40.63	3/20	.009	2.05
Commonwealth Edison	41.38	25	1.50	2.05
New York Central RR	44.44	No	6.00	2.20
Republic Aviation	44.81	1	.06	2.25
Radio Corp	44.94	No	6.00	2.25
Monsanto Chemical	45.13	2	.12	2.25
United States Rubber Co	45.69	5	.30	2.30
Baltimore & Ohio RR	46.81	100	6.00	2.35
General Motors (when issued)	49.25	1⅔	.10	2.45
Republic Steel	49.50	10	.60	2.45
Armco Steel Corp	50.00	10	.60	2.50
General Electric Co	50.25	5	.30	2.50
Standard Oil Co (Indiana)	50.44	25	1.50	2.50
Lockheed Aircraft	50.56	1	.06	2.55
Safeway Stores	51.31	5	.30	2.55
Fruehauf Trailer Co	51.38	1	.06	2.55
Reynolds Metals Co	51.38	No	6.00	2.55
Olin-Mathieson Chemical	56.19	5	.30	2.80
Sinclair Oil Corp	56.44	5	.30	2.80
United States Steel Corp	56.44	16⅔	1.00	2.80
Westinghouse Electric	56.81	12½	.75	2.85
Southern Pacific	58.00	No	6.00	2.90
American Cyanamid	58.31	10	.60	2.90
General Dynamics	60.38	3	.18	3.00
Warren Petroleum	60.50	3	.18	3.00
Boeing Airplane	66.31	5	.30	3.30
American Viscose (regular)	66.38	25	1.50	3.30
Anaconda Co	69.38	50	3.00	3.45
North American Aviation	69.69	1	.06	3.50
Northern Pacific	72.81	No	6.00	3.65
Phillips Petroleum	79.69	No	6.00	4.00
Royal Dutch Petroleum	81.13	13	.78	4.05
Gulf Oil (regular)	84.31	25	1.50	4.20
Amerada Petroleum	90.44	No	6.00	4.50
Chrysler Corp	96.88	25	1.50	4.85
Montgomery Ward & Co	98.38	No	6.00	4.90
Sears, Roebuck (old)	112.75	No	6.00	5.65
Kennecott Copper	115.50	No	6.00	5.75
Standard Oil (New Jersey)	140.81	15	.90	7.05
Bethlehem Steel	153.75	No	6.00	7.70
American Telephone & Telegraph	180.50	100	6.00	9.00
E. I. du Pont	231.38	5	.30	11.55

6. *Definition of certificates of indebtedness.*—Section 4311 of the code imposes a documentary stamp tax on all certificates of indebtedness issued by a corporation. As defined in section 4381, the term "certificates of indebtedness" means bonds and debentures; and also includes all instruments, however termed, issued by a corporation with interest coupons or in registered form, known generally as corporate securities. The tax on certificates of indebtedness has remained essentially the same since the Revenue Act of 1924. Prior to that time a tax at a lower rate was also imposed on promissory notes.

The Revenue Act of 1924 removed promissory notes from the scope of the tax. The tax continued to be imposed on instruments which were styled bonds, debentures, certificates of indebtedness, and such other instruments which had attached thereto interest coupons or were in registered form. Under Treasury regulations the imposition of the tax did not depend upon the name by which the instrument was called.

After 1929 corporations began borrowing large sums on long-term notes for capital financing. These notes were issued to private investors, such as banks and insurance companies, and contained provisions restricting further borrowing, the payment of dividends, and so forth.

In 1935 the General Motors Acceptance Corp. borrowed $25 million from 8 corporations, issuing 84 unsecured instruments, called notes, as evidence of the indebtedness. The notes were issued in series, but did not bear interest coupons and were not in registered form. Otherwise they resembled conventional corporate securities and their terms embodied the usual restrictive conditions associated with corporate certificates of indebtedness. In the case of *General Motors Acceptance Corporation* v. *Higgins*, (161 F. (2d) 593, cert. denied, 332 U. S. 810) the Court held that the promissory notes involved were debentures and, accordingly, taxable on issuance as such. Since that time there have been approximately 20 decisions handed down by the courts on this subject, with the decisions being fairly evenly divided as to the taxability of the instrument in question. In the case of *Leslie Salt Company* v. *U. S.* (110 Fed. Supp. 680, aff'd, 218 F. (2d) 91, cert. granted June 6, 1955) it was decided that two long-term nonnegotiable promissory notes in the amounts of $1 million and $3 million were not debentures and, therefore, were not taxable upon issuance. The appeal in the Leslie Salt case has been heard during the current term of the Supreme Court, but a decision has not yet been rendered.

In order to eliminate the possibility of tax avoidance in this area and to eliminate confusion, which has resulted in considerable litigation, it is suggested that the law be amended to specify that long-term promissory notes are subject to the tax imposed on the issuance of certificates of indebtedness by corporations. The imposition of the tax should be limited to long-term notes. It is not intended that a tax should be imposed on the ordinary short-term promissory notes.

7. *Transfers of worthless certificates of indebtedness.*—Section 4322 (a) (4) exempts from the stock transfer, imposed by section 4321, tax transfers by an executor or administrator to a legatee, heir, or distributee if it can be shown that the value of the stock transferred is not greater than the amount of the tax which otherwise would be imposed on the delivery or transfer.

It is suggested that the same exemption be made available where an executor or administrator transfers certificates of indebtedness to a legatee, heir, or distributee and the value of the certificates is not greater than the amount of the tax involved. Such treatment appears desirable to accord consistent treatment in the case of stock and certificates of indebtedness and also on the grounds that the tax should not wipe out the amount of the legacy, bequest, or distribution.

It is estimated that this would result in a very small revenue loss.

B. Agreement in principle

1. *Tax on issuance of stock when earned surplus is dedicated to capital account.*—Since the Revenue Act of 1932, the Internal Revenue Service has considered the issuance of certificates to be unnecessary for the imposition of the stamp tax on the issuance of stock. Prior to the Revenue Act of 1932 the tax was imposed on each original issue of certificates of stock. The Revenue Act of 1932 added the parenthetical phrase "or of the shares where no certificates were issued." Section 1802 (a) of the 1939 code was amended in 1947 to provide that in recapitalizations, where certificates are issued or shares where no certificates are issued, the tax is to be imposed only on the increase in the value of the new stock resulting from the addition to capital under the recapitalization.

The Service has construed the language in the 1939 code as meaning that taxable shares are created upon the dedication of new capital to outstanding shares, that is, the mere transfer of surplus or other capital not previously credited to the capital-stock account, results in the issuance of "shares" and will be taxable under the 1939 code and the corresponding section of the 1954 code.

This issue was involved in two court cases, namely, *United States* v. *National Sugar Refining Co.* (113 Fed. Supp. 157), United States District Court for the Southern District of New York, and *F & M Schaefer Brewing Co.* v. *United States*, unreported from the United States District Court for the Eastern District of New York, both of which cases were decided against the Government. These cases involved the increase of the stated value of no-par-value stock.

The Service's interpretation of the law appears correct in view of the background of its enactment. However, the law seems to be unreasonable in its effect. There is no issuance of stock in the situation under consideration. Furthermore, a transfer of surplus to capital account gives no real enhancement in the actual value of outstanding stock, since the assets already belonged to the company and its stockholders.

The Treasury Department, therefore, agrees that as a matter of principle, no issuance tax should be asserted on the mere dedication of earned surplus to capital. Specific mention is made of "earned surplus" because of the need to prevent possible avoidance of tax on the issuance of par-value stock for paid-in capital and surplus by designating most of the funds paid in as surplus and then dedicating the surplus to capital later on. Possible revenue losses from enactment of this change, however, prevents the Treasury Department from endorsing an actual change at this time.

2. *Statutory mergers and consolidations.*—Section 4301 of the Internal Revenue Code of 1954 imposes a documentary-stamp tax on each original issue of shares or certificates of stock issued by corporations, whether on organization or reorganization. Section 4321 imposes a documentary-stamp tax on each sale or transfer of shares or certificates of stock or of rights to subscribe for or to receive such shares or certificates of stock.

By the terms of the statutory language employed in the two sections, which is the same as that used in the 1939 code, the tax on the original issue of stock is separate and distinct from the tax on the transfer of stock or the right to receive it. For that reason, the Treasury Department has taken the position and has been sustained by the

courts under the provisions of the 1939 code in holding that where one corporation is merged into another and as a result shares of the acquiring corporation are issued directly to the shareholders of the component corporation, documentary stamps are to be affixed upon both the issuance of the shares by the acquiring corporation and upon the transfer to the shareholders of the component corporation of the right to receive the shares of the acquiring corporation (e. g., *American Processing & Sales Company* v. *Campbell* 164 F. 2d 918 (C. C. A. 7, 1948) cert. denied 333 U. S. 844; *U. S. Industrial Chemicals, Inc.* v. *Johnson*, 181 F. 2d 413 (C. C. A. 2, 1950)).

In most instances the existence of the component corporation vanishes to all intents and purposes as soon as its assets are transferred to the acquiring corporation. If the component corporation remains in existence at all, it exists as a mere shell. For that reason, it is suggested in the case of statutory mergers that only the tax imposed by section 4301 on the issuance of shares or certificates of stock be made applicable. However, the proposal is limited to cases where the stock or certificates of stock are issued directly by the acquiring corporation to the security holders of the component corporation.

The suggestion that only one tax be imposed upon the issuance of the shares or certificates of stock of the acquiring corporation is predicated upon a belief that as a matter of reason there is no occasion to impose a transfer tax in addition to the higher tax imposed on the issuance of the shares or certificates of stock by the acquiring corporation.

The foregoing discussion and proposal apply with equal force and merit to the case of statutory consolidations with respect to which the Internal Revenue Service has taken the same position (*M. T.* 3., 2 *C. B.* 257 (1942)). Accordingly, the proposal with respect to mergers should be understood to apply also to statutory consolidations.

The Treasury Department agrees in principle with this suggestion but because of the revenue loss that would be involved does not believe that current action is desirable.

3. *Odd-lot transactions.*—At the present time when an individual desires to sell less than 100 shares of listed stock (or the unit of trading on an exchange), he sells them to a so-called odd-lot dealer on the exchange paying the ordinary stock-transfer tax. The dealer customarily will then sell 100 shares on the market representing an aggregation of two or more odd lots which he has purchased again paying a transfer tax. Both of these taxes customarily are borne by the odd-lot customer. Thus, an individual owning less than 100 shares of a stock pays a double transfer tax.

It is believed that this is discriminatory treatment for the small stockholder, and it is agreed in principle that it would be desirable to remove this double tax. However, the Treasury Department is not in a position to make such a recommendation at the present time in view of the fact that the elimination of this double tax would probably involve a revenue loss of approximately $1 million a year.

VI. WAGERING TAX AND TAXES ON COIN-OPERATED MACHINES

A. Full agreement

1. *Liability of "runners" for the tax on wagers.*—An excise tax on wagers equal to 10 percent of the amount thereof is imposed by section

4401. The tax is imposed on "each person who is engaged in the business of accepting wagers." A person is considered to be in the business of accepting wagers if he is engaged as a principal who, in accepting wagers, does so on his own account, or if he makes it a practice to accept wagers with respect to which he assumes the risk of profit or loss.

In view of this interpretation of the law, administrative difficulties have been experienced in cases in which the so-called "runner" of a gambling group has been apprehended. The "runner" is the person who accepts wagers from players and also pays off wagers to players but does not assume the risk of profit or loss. Often the runner refuses or is unable to name the person for whom he is accepting wagers. In this type of case, the "runner" is subject only to the occupational tax of $50 (sec. 4411) and all efforts to impose the excise tax of 10 percent under section 4401 must be abandoned.

If the policy under which the Service now operates continues, the ultimate result may be that all persons supposed to be covered by the wagering tax will contend that they are "runners" or "agents" of persons unknown for whom they are "accepting wagers." Thus, the 10 percent excise tax will rarely be applied.

It is therefore suggested that section 4401 or 4411 be amended so that an agent who refuses or is unable to name his principal shall be deemed prima facie the principal for the purposes of the excise tax. This is consistent with the general principles of the law of agency. In any case the Service should be permitted to proceed against the agent in such a way that he will be required to at least name the person to whom he pays the amounts collected by him as wagers or if he refuses or is unable to do so, then he (the agent) will be considered the principal agent whom the 10 percent excise tax imposed under section 4401 will be asserted.

2. *Coin-operated amusement devices actuated by remote control.*—A special annual tax is required to be paid by every person who maintains for use or permits the use of, on any place or premises occupied by him, a coin-operated amusement or gaming device defined in section 4462 (a) (1) and (2) respectively. Section 4462 (a) (1) defines the term "coin-operated amusement device" to mean any amusement or music machine operated by means of the insertion of a coin, token, or similar object.

In recent years there has been introduced a type of amusement device which is of the taxable type but which is actuated by some method of remote control which permits the machine to be operated without the insertion of a coin, token, and so forth. There are several methods of remote control which are so used. For example, a drugstore maintains three amusement devices. A person who desires to operate any one of these devices informs the clerk who after receiving payment from the player activates the machine for use by the "throwing" of a key available to the clerk. Since these machines are not operated by the insertion of a coin, token, and so forth, they are not subject to tax and thus present an area of tax avoidance.

It is suggested that section 4462 be amended so that the definition contained therein of a coin-operated amusement device will include the type of machine described above.

PART 2: EXEMPTION AND REFUND PROCEDURES

I. MAJOR EXEMPTION AND REFUND OR CREDIT PROVISIONS

The principal exemptions under the manufacturers' excise taxes are those for futher manufacture, for export, for sales to State and local governments, for supplies for vessels and airplanes, and for certain foreign diplomats. Some of these exemptions also are available in the case of the retail excises and the taxes on communications and transportation. Different methods of exemption and refund or credit are available for the different sorts of purchasers. It is suggested that a more uniform system of exemptions and refunds or credits be established for manufacturers' sales (or resales) for further manufacture, for export, to State and local governments and for fuel supplies, etc., for certain vessels and aircraft. The same rules would also apply in the case of sales for export in the case of the retail taxes, and to sales to State and local governments in the case of both the retail taxes and the taxes on communications and transportation.

It is also suggested that the exemption and refund or credit procedure outlined below be applied in the case of the special exemptions presently provided by law, which in reality represent a form of exemption for further manufacture. These would include the exemption for lubricating oils sold to a manufacturer of lubricating oils for resale by him (sec. 4093), the exemption for sales of gasoline to a producer of gasoline (sec. 4083) and the exemption for auto or truck bodies or parts or accessories sold to a manufacturer of trucks or automobiles (sec. 4063).

A. A possible system in general terms

The system outlined here contains two alternative methods for obtaining articles free of tax: one would provide for tax-free sales all the way through the chain of production and distribution; the other would provide refunds or credits for articles sold on a tax-paid basis but which were subsequently freed of tax as a result of use for one of the specified purposes such as further manufacture, sale for export, sale to a State or local government, or sale for fuel supplies, etc., for certain vessels or aircraft.

Tax-free purchases would be permitted initially if the vendee indicated at the time of the sale that he intended to use or resell the article for any of the specified purposes. Tax-free purchases for resale, however, would be limited to those where only one dealer intervened between the initial manufacturer and the purchaser who uses the article for further manufacture, exports it, is a State or local governmental unit, or is a person purchasing tax free for the specified types of vessels or aircraft.

Certain exceptions to the above general rules would be made, however, in the case of tires, inner tubes, and automobile radio and television sets because of the relationships of the taxes on these articles to those on automobiles and trucks. As at present, tax-free

purchases for these articles for further manufacture would not be allowed, although where such articles are incorporated in automobiles or trucks a credit would be allowed against the auto or truck tax equal to the price paid for the tire, inner tube, auto radio, or television set multiplied by the tax rate on autos or trucks. Tax-free purchase of these articles would be allowed, however, for export, for sale to State or local governmental units, and for supplies, etc., for certain vessels and aircraft.

B. Tax-free purchases

To obtain an article free of tax from a manufacturer, a purchaser would have to indicate that the article was to be used or sold for one of the specifically exempt purposes (with the exception noted above for tires, inner tubes, and auto radios and television sets).[4] This differs from present procedures in that sales for manufacture, for export, to State or local governmental units, or for supplies for vessels or aircraft would no longer constitute separate categories. A purchaser need only indicate that he intends to use or resell the article for any of these purposes. He would also be required to provide proof that the article was used or sold for one of these purposes within 6 months of his purchase (i. e., from the date of the transfer of title or shipment, whichever occurred first). Where the proof is not obtained within the 6 months' period, the initial manufacturer would become taxable with respect to the sale. If subsequently the purchaser should use or resell the article for any of the specifically exempt purposes, a refund or credit could be obtained in the same manner as indicated below in the case of purchases initially made on a taxpaid basis.

As under present law, one exception would be made to this presentation of proof within 6 months, i. e., where the purchaser is himself a manufacturer. This exception would be provided for manufacturers because they may frequently hold the articles as inventory for extended periods of time. Also, in the case of sales to manufacturers, it is possible to hold them responsible for the payment of the tax, should they subsequently sell it for a taxable purpose, in the same manner as the initial manufacturer. The tax base in this case could be the purchase price of the vendee-manufacturer, or at the option of the vendee-manufacturer the sales price of the original manufacturer if he is in a position to provide proof of the amount of such price. The two bases would differ only where there were intervening dealers.

As applied under present law, the system described above provides that no manufacturer would be required to make tax-free sales for any of the prescribed purposes (except where the sale was made directly to a State or local governmental unit). Thus, vendor-manufacturers would not be required to accept responsibility for the payment of any tax ultimately determined to be due in those cases where they might have reason to question the likelihood of the ultimate collection.

The recommended tax treatment outlined above for tax-free sales is substantially the system already in use in the case of sales for further manufacture and sales for export. However, the proposal would for the first time provide that sales could be made tax free for resale to a

[4] The system outlined here would apply to retail taxes to the extent the exemptions are applicable, but the present exemption requirements would be kept for the State and local government exemption with respect to the taxes on communications and transportation.

State or local governmental unit or for resale as supplies for vessels or airplanes. This presently cannot be done even where it is known at the time of the sale that the article will be resold for such a purpose. The present system in this respect appears unnecessarily cumbersome in requiring the collection of a tax where it is known that eventually no tax will be due. Moreover, the distinction in the present system, if it were to be continued, would prevent the adoption of a single comprehensive exemption and refund system for all major exemptions.

C. Registration in lieu of exemption certificates

Under present law the exemptions provided by section 4220 with respect to sales or resales for further manufacture are conditioned upon the compliance with regulations prescribed by the Secretary or his delegate. Under this authority a registry and exemption system has been set up. The regulations provide that no otherwise taxable article may be sold tax free unless the vendor and vendee have each registered with the local district director of internal revenue. Each person qualifying is given a registration certificate containing a registration number. The Commissioner is authorized to cancel the registration certificate where he is satisfied that the registrant is not a bona fide manufacturer of taxable articles or a vendee making resales directly to such manufacturers, or where the tax-free sales are being made for purposes not warranted by the law and the regulations.

In order to establish the right to exemption the registered vendor must obtain from his registered vendee prior to, or at the time of the sale (and retain in his possession) a so-called exemption certificate showing that the vendee is a manufacturer of taxable articles and that the article purchased is to be used by him as material in, or a component part of, another taxable article. An exemption certificate may be furnished for each sale, or one certificate may be provided covering all orders over any period of time not in excess of 1 month.

Registration is not provided for in the case of sales for export, sales to State and local governmental units, or sales for supplies for vessels or aircraft, although exemption certificates are required in the two latter cases.

Under the suggestion outlined here the registration procedure presently in use in the case of sales for further manufacture would be retained and also applied in the case of sales for export, to State or local governmental units, and for sales for supplies for vessels and aircraft. It is recommended that provision be made for the permanent registration of purchasers for any of the exempt purposes and that tax-free sales be made only to such purchasers. Thus, only once would there generally need be a showing of use or sales of the prescribed type. However, the Internal Revenue Service could be given the power to require a showing from time to time that tax-free sales are still being made and also the power to deny further registration for a period of time in abuse cases.

Under this system, exemption certificates would no longer be required. Sufficient proof of a tax-exempt sale would be evidenced by a notation on the sales order or purchase order of the registration number of the exempt purchaser. The use of the registration number on a sales order would constitute an acknowledgment on the part of the purchaser that he was buying the articles for an exempt purpose. The willful misuse of such registration number would make the vendee

subject to criminal penalties. It should be noted that under present law the notation on a sales invoice, or at least the association of the sales invoice with the exemption certificate, is required in addition to the use of a certificate so that the retention of the notation on the sales invoice represents no new requirement. On the other hand, the elimination of exemption certificates should represent a substantial administrative simplification.

On an optional basis, State and local governmental units should be permitted to use exemption certificates to make tax-free purchases instead of using the registration procedure.

D. Procedure for refunds or credits

It is suggested that where a sale is made by the initial manufacturer on a taxpaid basis and the purchaser subsequently uses or sells the article for one of the prescribed exempt purposes, a refund or credit be allowed upon proof of such a sale.[5] The refund or credit would be allowed whether or not there had been an indication at the time of the initial purchase that the article was intended for use for one of the specified exempt purposes. This same refund or credit device would also be available in those cases where a sale was initially made on a tax-free basis but, because use or resale for an exempt purpose was not shown within a 6-month period, tax was subsequently paid. Such cases from the standpoint of refunds or credits would be treated in the same manner as if the articles originally had been purchased on a taxpaid basis.

It is suggested that the refund or credit be made through the initial manufacturer even where the sale is made to another manufacturer who did not have to meet the 6-month proof requirement.[6] Thus, where a dealer exported a quantity of tax-paid items he could do so on a tax-free basis and present a claim for a refund or credit to his vendor, who in turn would present the claim to the initial manufacturer. The initial manufacturer before or after having received the refund or credit from the Government (depending on the arrangement between the parties) would then pass the benefit on down through to the exporter. Where more than one dealer intervenes in the distribution process between the initial manufacturer and the ultimate sale for one of the specified exempt purposes, this refund or credit route would be the only means available for obtaining relief from tax.

The refund or credit route described above is already available in the case of sales to State or local governmental units, and in the case of sales for supplies for certain vessels or airplanes. A refund or credit is now also available in the case of sales for further manufacture but a manufacturer to whom such a sale has been made (but not a dealer who planned to sell to such a manufacturer), obtains the refund or credit directly instead of through the original manufacturer. A refund or credit is presently available in the case of sales for export only where there was knowledge at the time of the original sale that the article was being purchased for export. Not only is the uniform treatment for the various major exemptions desirable, but also the

[5] As previously suggested, a special credit would be allowed for tires, inner tubes, auto radios, and auto television sets incorporated in automobiles or trucks and the general refund or credit in the case of sales for further manufacture would not be available in the case of these articles.

[6] Going back to the vendor-manufacturer in the case of refunds or credits involving vendee-manufacturers appears necessary since the articles may have been sold on a tax-paid basis through dealers to the vendee-manufacturer and it may be impossible to determine the price on which the tax was paid except by tracing the transaction back in this manner. This would not apply, however, to the special credit in the case of tires, inner tubes, auto radios, and auto television sets.

deletion of the advance knowledge requirement in the case of exports will remove a hardship on which a considerable volume of complaint has been received with respect to dealers who export important quantities of goods but do not know, at the time they make their purchases, that the sales will be made abroad. Problems of this type have been especially pressing in the case of the tax on lubricating oil.

E. Accounting methods for refunds or credits

At present the regulations generally require a claim for credit or refund to be supported by evidence showing the name and address of the person who paid the tax, the date of the payment, the amount of the tax, and that the article was used for a tax-free purpose. Specific identification of each product becomes very difficult where a person has obtained large quantities of substantially the same type of product from different manufacturers. In such cases it becomes virtually impossible to determine from which of several manufacturers specific products were purchased.

To overcome this problem it is suggested that persons be permitted to employ a first-in, first-out method for identifying purchases from various manufacturers as a substitute for the specific identification required by the present regulations. This should substantially ease compliance problems in connection with the present credit and refund provisions. Moreover, it is believed that it will more nearly conform with what in reality constitutes present practice than do the present regulations.

II. SPECIAL EXEMPTION OR REFUND PROBLEMS

A. Areas of double taxation or faulty applications of exemptions

1. *Problems with respect to tires and inner tubes, and automobile radios and television sets.*—Section 4220 provides an exemption from manufactures' excise tax for articles sold, or resold, for further manufacture. The third sentence in this section specifically makes this provision inapplicable in the case of tires, inner tubes, and automobile radio or television receiving sets. Similar treatment is provided in the case of credits or refunds. Section 6416 (b) (3) provides a refund or credit for articles on which a manufacturers' excise tax has been paid which are used, or resold, for further manufacture. However, this provision by its terms does not apply in the case of the taxes on tires and inner tubes, and automobile radio and television sets. Instead of allowing either tax-free sales or the ordinary refunds or credits with respect to these articles, a special crediting device has been provided by section 6416 (c). The credit is available only where these articles are sold on or in connection with the sale of an automobile, truck, etc., taxable under section 4061 (a). The credit to be allowed against the automobile or truck tax is to equal an amount determined by multiplying the appropriate tax rate applicable to automobiles or trucks (presently 10 percent or 8 percent) by the manufacturer's purchase price for the tires and tubes or automobile radio or television receiving set.

This special crediting device is used because the taxes on tires, tubes, radios, and television sets generally have been different than and generally higher than the taxes on automobiles and trucks. Thus, to allow tax-free purchases of these articles for incorporation in an automobile or truck would have meant that the articles used

in this manner would have been taxable at a different net rate than similar articles not added to new cars or trucks.

The present crediting device for tires, tubes, and automobile radio and television sets has created a number of problems. One of them arises from the fact that the credit in the case of tires and tubes is limited to those mounted on automobiles or trucks. The credit is not available where the tire or tube is mounted on what is classified as an automotive part or accessory, as is true in the case of so-called trailer dollies.

A similar problem has arisen in the case of power lawnmowers having pneumatic tires (as distinguished from solid or hollow center small tires of all rubber construction) and tubes. In this case, also, a poundage tax is first imposed on the pneumatic tire and tube and then the 5 percent electric, gas, and oil appliance tax is imposed upon the entire power lawn mower, including the tires and tubes.

A related problem also arises with respect to this credit in cases where these articles are sold for use as component parts of automobiles or trucks which themselves are free of tax because they are exported, or because they are sold to a State or local governmental unit. Since section 6416 (c) of present law allows a credit only against the tax on automobiles or trucks with respect to the purchase price of the tire, tube, or auto radio or television set, it would appear that if no tax is imposed upon the automobile or truck, no credit could be claimed with respect to the tax on tires, tubes, or auto radio or television sets. On the other hand, however, sections 4224 and 4225 in the case of manufacturers' excise taxes (and the corresponding sections in the other excise taxes) provide specifically for the exemption of articles sold for the exclusive use of a State or local governmental unit or for export or shipment to a possession.

When tires are mounted on an automobile which is exported the Internal Revenue Service has held that the manufacturer is entitled to receive a credit or refund not only for the tax paid with respect to the automobile, but also with respect to the tax paid on the tires and tubes. In some instances automobile manufacturers have even been permitted initially to purchase the tires and tubes tax free where the automobile was to be exported. On the other hand, in the case of tires mounted on cars sold to States or local governments, the regulations preclude the allowance of a refund or credit for the tire or tube taxes. The Service believes that its position with respect to the State and municipal exemption is correct and that its position with respect to exports is wrong. Nevertheless, the present treatment for exports is being continued, since the ruling in this case has been in effect for some 21 or 22 years. In the absence of a change in the law or a court decision, it is felt that the Service should not reverse a position held this long.

2. *Suggestions with respect to the credit for tires, tubes, and auto radio and television sets.*—To prevent a double tax, tires, tubes, auto radios, and auto television sets would have to be free of tax when sold on or in connection with other articles subject to a manufacturers' excise tax (or eligible for a refund or credit when sold on a tax-paid basis). The relief could be provided by expanding the crediting device presently provided in section 6416 (c) in the case of the excise tax on automobiles and trucks to allow a credit, with respect to taxes on

the specified articles, against any manufacturer's tax in the manner now provided in the case of the tax on automobiles or trucks.

The above suggestion would continue the tax with respect to tires, tubes, auto radios and auto television sets when sold on or in connection with other articles which are not subject to manufacturers' excise tax. In this respect these articles are (and would be) treated less favorably than auto parts and accessories, radio and television components, refrigerator components, and camera lenses. These latter items not only are free of tax if incorporated in another article subject to a manufacturers' excise tax, but also are free of tax if incorporated in another article not subject to manufacturers' tax. This difference in treatment between these parts or components on one hand, and the tires, tubes, and auto radios and television sets on the other, appears to be justified on the grounds that the former are basically only components while the latter are end articles in and of themselves.

With respect to tires, tubes, and auto radios and television sets incorporated in, or sold in connection with, articles (such as automobilies or trucks, but not limited to these items) which are sold for export or sold to State or local governmental units, it would be desirable to allow tax-free sales (or credits or refunds) in the same manner as for other articles sold for export or to State or local governmental units. This would remove the present inconsistent treatment between exports and sales to governmental units, and would tax the articles in the same manner as other manufacturers' excises where the articles are ultimately exported or sold to a governmental unit.

3. *Problems arising where clocks are combined with other articles.*—Where clocks have been combined with other items subject to a manufacturers' excise tax, the Service has followed the practice of taxing the entire combination at the manufacturers' level. This has been true, for example, in the case of clock radios. Also, in the case of auto clocks the manufacturers' auto part and accessory tax has been applied rather than the retail jewelry tax. In the case of auto clocks this treatment was accorded on the grounds that these clocks constituted automotive parts or accessories and therefore could be taxed under a manufacturers' tax rather than as clocks subject to the jewelry tax. Apparently the same rationale has been used in subjecting clocks combined with radios to the manufacturers' radio tax.

Clocks combined with nontaxable items have been held subject to the retail tax on jewelry on the portion of the combination representing the clock. This has been true, for example, in the case of thermostat controls combined with clocks. Where clock mechanisms are used as timing devices, but no clock face appears, the Service holds that no tax is presently due.

The tax treatment accorded these clock combinations by the Service appears to be both a practical and rational method of taxation. However, there is little or no statutory authority for the imposition of the manufacturers' tax, rather than a retail tax, where clocks are combined with other items subject to the manufacturers' tax. In fact, under the 1954 code it could well be argued that the opposite effect should apply. Section 4221 provides that none of the manufacturers' excise taxes are to be imposed on any article taxable as jewelry. Under the 1939 code this provision did not apply in the case of radios and auto parts and accessories and, therefore, the treat-

ment provided by the regulations did not appear to be in conflict with the 1939 code.

While no change is suggested with respect to practices followed by the Service with respect to clock combinations, it is suggested that the code be amended to make it clear that where clocks are combined with other articles subject to a manufacturers' excise tax, the manufacturers' tax is to apply to the entire combination.

B. Technical problems in the manufacturers' taxes

A number of relatively minor technical points have been raised with respect to the refund and exemption provisions in the case of various manufacturers' excise taxes. For the most part these represent errors or ambiguities in recently enacted provisions. They are discussed briefly below.

1. *Sale of certain parts or components as repair or replacement parts.*—Public Law 367, approved August 11, 1955, made certain amendments to section 4220 (providing an exemption for sales or resales to manufacturers for further manufacture) which some believe had the effect of exempting from tax certain parts or components used, or sold, as repair or replacement parts. Specifically, this act amended section 4220 to provide an exemption from manufacturers' excise tax for automobile parts or accessories, refrigerator components, radio or television components or camera lenses sold for use, or resale, in the manufacture of, or as a component part of, any article.

It is thought by some that Public Law 367 had the effect of exempting from tax parts or accessories sold as repair or replacement parts (including parts used by a manufacturer in a repair service for a customer) since these parts in a sense at least are "incorporated in" other articles. This line of argument would completely free auto, radio, television, and refrigerator parts and camera lenses from tax. That this was not the intention of Congress is clearly indicated by the following sentence from the House and Senate reports on Public Law 367:

> The adoption of a single rule exempting parts, accessories, or components from tax, *except where they are sold for repair or replacement use*, will provide greater equity and simplify administration and compliance. [Italics supplied.]

It is suggested that section 4220 should be amended to make the congressional intent clear in the statute.

2. *Use by manufacturer of certain parts or components.*—Public Law 367 also amended section 4218 to provide that no tax is to be due with respect to the use of one of the parts or accessories specified above, which the manufacturer himself uses in the manufacture of any other article. Here as in the case of the sale the question arises as to whether the tax applies to parts or accessories used in a manufacturer's plant operations as repair or replacement parts.

It appears inconsistent to exempt these parts or components from tax where the manufacturer uses them himself as repair or replacement parts yet tax them if someone else uses them for such a purpose. It appears undesirable, for example, to exempt auto parts from tax where they are used by the manufacturer to repair trucks used in his own business or to exempt radio tubes used as replacements in radio or television sets which are damaged while still in the manufacturers' hands.

It is suggested that section 4218 be amended to make it clear that with respect to automobile parts and accessories, radio and tele-

vision components, refrigerator components and camera lenses, a tax is still to be imposed where such parts are used by the manufacturer as repair or replacement parts.

3. *Definition of refrigerator components.*—Section 4111 of the 1954 code imposes a manufacturers' excise tax on "refrigerator components." As defined in section 4112, the term component means certain specified parts "except when sold as component parts of complete refrigerators, refrigerating or cooling apparatus, or quick freeze units (hereinafter referred to as 'refrigerating equipment')."

Public Law 367, enacted on August 11, 1955, makes this exception no longer necessary and, in fact, makes its deletion desirable in order to avoid confusion as to the application of this tax. Public Law 367 exempts from manufacturers' excise tax refrigerator components (as well as auto parts and accessories, radio and television components, and camera lenses) which are used as material in or as component parts of any article whether or not taxable. Thus, Public Law 367 achieves on a broader basis the result obtained by the exception in section 4221 and makes the exception in 4221 no longer necessary.

C. Documentary stamp taxes

1. *Statute of limitations for stamp taxes.*—At the present time there are certain differences in the stamp taxes in the time from which the 3-year statute of limitation begins to run in the case of assessments and in the case of claims for credit or refund. Still different treatment is also provided for the redemption of stamps.

Section 6501 provides that if a tax is payable by stamp, the statute runs within 3 years "after such tax became due. * * *" Section 6511 (a), on the other hand, provides that a claim for a credit or refund of an overpayment of a tax required to be paid by stamp is to be filed within 3 years "from the time the tax was paid."

There appears to be no reason for the use of two different rules in the case of assessments and claims for refund or credit. Moreover commencing the period in the case of assessments with the due date of the tax appears to be overgenerous. The nonpayment of a stamp tax appears to be approximately the equivalent of not filing a return, and where no return has been filed, the statute does not commence running in the case of these taxes. To remove this advantage for stamp taxes and to equate the statute of limitations in the case of claims and assessments, it is suggested that section 6501 be amended to provide that the period of limitations should commence running in the case of assessments from the time the stamp tax is paid rather than from the time the tax became due. Thus, where no stamp tax is paid the statute will remain open indefinitely; where a tax is paid, even though inadequate, the period of limitations will run from that date.

Section 6805 provides that the Secretary or his delegate may redeem stamps (1) which have been spoiled, destroyed, or rendered useless or unfit for the purpose intended, or (2) for which the owner may have no use, or (3) which through mistake may have been improperly or unnecessarily used, or (4) where the rates or duties have in any manner been wrongfully collected. A claim for the redemption of stamps under this section must be presented within 3 years after the purchase of the stamps from the Government.

This period of limitations in section 6805 with respect to the redemption of stamps, to the extent it relates to used stamps, appears

to be in conflict with the period of limitations provided by section 6511 for claims for credits or refunds of stamp taxes. Section 6805, as noted above, provides that the period is to begin running with the purchase of the stamps, while section 6511 provides it is to commence running as of the date the tax is paid or the stamps are affixed. To remove this conflict it is suggested that section 6805 (a) be amended by striking out the third and fourth categories for which redemption can be made, i. e., those where the stamp has been improperly or unnecessarily used, and where the rates or duties have been wrongfully collected. It is also suggested that subsection (c), which provides the redemption period of 3 years from date of purchase, be amended to make it applicable only to unused stamps.

2. *State and local government tax liability in the case of real-estate conveyances.*—Section 4361 imposes a documentary stamp tax on certain conveyances of real estate. Although there are some exemptions from this tax, no exemption is provided in the case of the conveyance of real estate by, or to, a State or local governmental unit. Section 4383 of the code imposes liability for the stamp tax upon both the person who makes, signs, or issues the document and upon the one for whose benefit the document is made, signed, or issued. As a result, if one party to a taxable transaction is exempt, the tax is still collected from the other or nonexempt party. Internal Revenue Ruling M. T. 39 (C. B. 1950–1, 141) provides that a State or local government is immune from the documentary stamp tax on the conveyance of real estate when it is acting in its "governmental" capacity in transferring, or acquiring, real property from a private purchaser. However, the nonexempt party is held subject to the documentary stamp tax in the case of both transfers of real property to, and acquisitions of such property from, State or local governmental units.

It is suggested that the treatment presently provided for State and local governmental units be added to the statute but that no distinction be made between transfers or acquisitions for governmental as distinct from proprietary functions. The statute would then provide that in no case would a tax be collected from the State, thus affording the same treatment for States and local governments as the law now provides for the Federal Government.

D. Club-dues tax

1. *Power of attorney required in the case of claims for credit or refund.*—Section 6415 (a) provides that a credit or refund for overpayments of the club-dues tax is to be allowed to the person who collected the tax if such person can show that he has repaid the amount of the tax to the person from whom he collected it or if he has obtained the consent of such person to the allowance of the credit or refund. Although this is almost identical to 2 of the 3 conditions imposed in the case of overpayments of manufacturers' excise taxes, the regulations in this case have provided a much stricter procedure which must be followed before repayment of any tax. The regulations provide that where a club as agent for its members seeks a refund of tax collected by it, since the members and not the club are the actual taxpayers, the claim must be accompanied by the following:

(*a*) An alphabetical list of the names of the taxpayers, showing the amount claimed for each and the dates on which the amounts were paid;

(*b*) The power of attorney executed by each person for whom a claim is filed;

(*c*) A copy of the constitution, bylaws, or other rules and regulations of the organization, together with amendments.

Complaints have been received that requiring the club to obtain a power of attorney for each person for whom a refund is being claimed is unduly burdensome. Although the statutory provision governing refunds of overpayments in the case of manufacturers' excise taxes is quite similar, the regulations require no such power of attorney in that case.

After a discussion of this problem with representatives of the Internal Revenue Service, it was agreed an appropriate revision of the regulations would be made to provide that an indication of consent, rather than the execution of a power of attorney will be a sufficient basis on which to allow a credit or refund. The procedure to be followed in such a case will be substantially the same as is presently followed in the case of the manufacturers' excise taxes.

2. *Refund of tax in case of refund of initiation fee.*—Section 6415 (d) provides for a refund of the club-dues tax where the payment on which it was based has been refunded. In the past the Internal Revenue Service has interpreted this as providing for refunds in the case of initiation fees only in the event that a membership payment has been rejected. However, this subsection clearly requires a refunding of the tax where an initiation fee is repaid to a member, irrespective of how long ago the initial payment with respect to the initiation fee had been made. This interpretation has now been adopted by the Service.

This appears to be the proper result since the tax with respect to initiation fees is in effect a tax with respect to what might be considered the assets or working capital of the club. As these funds are reduced by repayments to members, it appears only proper that the tax also be reduced. To do otherwise would result in the payment of varying taxes with respect to two clubs maintaining the same amount of working capital, where membership in one of the clubs turns over more rapidly than in the case of the other.

E. Cabaret tax

Section 6416 (a) provides for credits or refunds of overpayments of tax imposed with respect to the cabaret tax and the tax on the transportation of oil by pipelines, as well as in the case of retail and manufacturers' excise taxes. However, 1 of 3 conditions set forth in the subsection must be met before a refund or credit is allowed. These are: (1) A showing that the burden of the tax was not shifted forward to the consumer of the article or service; (2) repayment of the tax to the purchaser in the case of retail excises, or ultimate purchaser in the case of manufacturers' excises (or with an agreement to repay in the case of certain types of claims); or (3) the filing with the Treasury of the written consent of the purchaser or ultimate purchaser to the allowance of the credit or refund.

The first of these three conditions clearly applies in the case of the cabaret tax and the tax on the transportation of oil by pipeline. The Service has held, however, that the second and third conditions do not apply in the case of these taxes because the references in the second paragraph are only to retailers' or manufacturers' taxes.

Under the suggestion in I above the statute would be revised to make it clear that a refund of the cabaret tax and the tax on the transportation of oil by pipeline will be made where the amount of the tax has been repaid to the consumer of the service, or where the consumer of the service gives permission to the performer of the service to the allowance of the credit or refund. For purposes of uniformity, and also on the basis of equity, it would appear proper that all three procedures for making refunds be made available in the case of the cabaret tax and the tax on the transportation of oil by pipeline.

III. FLOOR STOCK REFUNDS

The 1954 Internal Revenue Code now contains provisions for refunds on taxpaid floor stocks for (1) alcoholic beverages, (2) cigarettes, (3) gasoline, (4) automobiles and trucks, and (5) automobile parts and accessories which are scheduled for automatic rate reductions as of April 1, 1956. There is also a provision in the code for refund of the tax paid on imported sugar or imported articles composed in chief value of sugar which are held by the importer on June 30, 1957, at which time the tax on the sale or importation of sugar is scheduled to terminate. The methods for paying refunds vary among the different taxes with unnecessary complications in the law. Aside from this, experience with the floor stocks refunds under the Excise Tax Reduction Act of 1954 pointed out the need for revision in some of the provisions now in the code. Also, the provision for refunds in 1956 on floor stocks of automobile parts and accessories was placed in the 1954 code as a result of a transposition of subsections during the revision process.

A. Provisions in present law

under present law for filing the claim for refund. The alcoholic beverage and cigarette provisions provide that the person holding the taxed items is to file the claim. Similarly, the sugar provisions provide for filing by the importer who paid the tax.

The gasoline refund provision uses a second pattern. Here it is provided that the dealer is to file a claim for refund with the producer or importer who paid the tax, and the producer or importer, after reimbursing the dealer, is to file a claim for credit or refund with the Government.

The third pattern, used in the case of motor vehicles and automobile parts, is a dual claim system. First, the manufacturer or producer may file a claim with respect to tax-paid floor stocks of his dealers. After having been allowed the claim by the Government, the manufacturer is to remit the refund to the dealer to the extent that the tax represented by the refund was included in the price paid by the dealer. Alternatively, the dealer may file claim directly with the Government, if the manufacturer or producer waives the right to claim the refund.

2. *Time for filing claims.*—The various refund provisions also differ considerably in the time allowed for filing refunds. In the case of alcoholic beverages, claims for refunds must be filed within 1 month from the date of the tax reduction or within 30 days from the promulgation of the regulations on refunds. For cigarettes, claims must be filed within 3 months from the date of the tax reduction. For motor

vehicles, automobile parts, and gasoline claims also must be filed within 3 months from the date of tax reduction. The provisions for refunds on floor stocks of imported sugar contain no special time limitation as to the period for filing claims.

3. *Other provisions.*—There are also several other details in which the various refund provisions differ. For alcoholic beverages and cigarettes, it is provided that the persons requesting credits or refunds are to keep such information on inventories, sales, and purchases for periods both before and after April 1, 1956 (but not extending beyond 1 year thereafter), as are prescribed by regulations. The refund provisions on motor vehicles, automobile parts, and gasoline require such evidence of inventories with respect to which refunds or credits are claimed as may be prescribed by regulations. In addition, the gasoline refund provision requires establishment that a quantity of gasoline equal to that on which floor stocks refund or credit is claimed was sold on or after April 1, 1956, at a price to the ultimate consumer which reflected the amount of the tax reduction. A similar requirement for passing on the tax reduction was previously in the provisions for refund with respect to taxpaid floor stocks of alcoholic beverages and cigarettes but was eliminated in the 1954 code.

B. Suggested revisions for floor stock refunds

1. *General revision of present floor stock refunds of manufacturers' excises.*—Under the Excise Tax Reduction Act of 1954, which provided for refunds on electric light bulbs, refrigerators, and electric, gas, and oil appliances, claims for refunds were filed by dealers with the manufacturers or importers. The manufacturers or importers were required to verify these claims and then refund the amounts verified to the dealers. Generally speaking, this system was found to be satisfactory, and its further use is recommended.

The 1954 refund system was not satisfactory with respect to the time factors involved. In the first place, except for electric light bulbs, there was no provision that dealers must file their claims with the manufacturers prior to the last day the manufacturers themselves were allowed to file claims with the Government. Consequently, the manufacturers either had to set up an arbitrary cutoff date for dealers' claims prior to their time of filing, or else be faced with the necessity of trying to process all the dealers' claims at the last moment. Moreover, manufacturers had to pay the dealers' claims prior to the time they filed their own consolidated claim with the Government. This placed another timing squeeze on the manufacturers, and in some cases a fiscal burden because they had to pay out money or give credit prior to the time that they received any benefit from the Government. Another inadequacy of the 1954 procedure arose from failure to coordinate the manufacturers' filing date with their normal filing date for payment of taxes. As a consequence of this, manufacturers could not claim a credit against taxes due unless they speeded up the filing of their regular quarterly excise returns.[9] To meet these three problems it is suggested that certain changes be made in the present law.

(*a*) It is suggested that dealers be required to file their claims with the manufacturers at some time prior to the time manufacturers

[9] This applies only where three or more monthly deposits are required under the depositary receipt system.

have to file their claims. It is recommended that dealers be allowed a period of 2 months and 10 days after the rate reduction date for the filing of their claims with the manufacturers. Manufacturers would then be given an additional period of at least 1 month, or possibly as much as 3 months for the compiling of these claims of the dealers and making a claim with the Government. Thus the overall period would vary from 3 months and 10 days to 5 months and 10 days.

This compares with an aggregate 3-month period which exists in most cases under present law. The variation in the filing date for manufacturers is suggested in order to make the filing of these refund claims coincide with the quarterly filing date for excise taxes generally. This is explained further below.

(*b*) It is recommended that manufacturers not be required to pay dealers their claims prior to the time the manufacturers file their claims, or even prior to, or at, the time the manufacturers receive the benefit of the credit or refunds from the Government. Instead it is recommended that the manufacturers be required to state that within 30 days after they receive a refund (or notice of allowance for claim of credit) they will pass it on to the dealers.

(*c*) It is recommended that the filing of claims be integrated with the filing of their quarterly excise tax returns. A provision for integration of floor-stocks refunds with the quarterly return system of manufacturers would provide, as indicated above, that dealers would have a period of 2 months and 10 days to file their claims for refund with their manufacturers. Manufacturers would have a variable time lag to file their claims depending on the relationship of the reduction date to the quarterly filing date. The filing date for manufacturers would be the next date for filing quarterly returns at least 3 months and 10 days after the rate reduction date. Thus the filing date for January, February, and March collections is May 10. In the case of a reduction effective—

(i) On January 1, the dealers would file their claims with their manufacturers on March 10, and the manufacturers would file their claims 2 months later on May 10;

(ii) On February 1, the dealers would file claims with their manufacturers on April 10, and the manufacturers would file their claims 1 month later on May 10; or

(iii) On March 1, the dealers would file claims with their manufacturers on May 10, and the manufacturers would file their claims 3 months later on August 10, the next filing date for quarterly returns.

2. *Price reduction requirement for gasoline.*—The requirement that gasoline prices be reduced to reflect the refund on tax-paid floor stocks was inserted in the law in 1951 when the floor stocks provision was originally enacted. As such, it is a carryover of a similar provision that was placed in the law with respect to alcoholic beverages when provision for refunds on floor stocks was made by the Revenue Act of 1945. The 1945 provision represented a reaction to the short supply situations in existence at that time. While undoubtedly desirable from a theoretical point of view, such a provision would be difficult to prove compliance with and also to administer. Under present day conditions of adequate supplies, it would seem that competition generally would supply adequate safeguards for the

interest of consumers. Consequently, this provision could be repealed as was done in the case of alcoholic beverages and cigarettes in 1954.

3. *Automobile parts and accessories.*—Congress provided for refunds on tax-paid floor stocks of passenger automobiles and trucks in the Excise Tax Reduction Act of 1954; no provision was made at that time for refunds on automobile parts and accessories. The refund provision originally was in section 3403 (f) of the 1939 code. It provided for floor stocks refunds on articles taxed under section 3404 (a) and (b) at the time when the taxes on such articles were reduced. Subsections (a) and (b) at that time covered trucks and passenger automobiles. Automobile parts and accessories were taxed under subsection (c). When these taxes were transferred to the 1954 code as section 4061, the taxes on passenger automobiles and trucks were placed in subsection (a) and the tax on parts was put in subsection (b). The floor stocks refund provision which is now section 6412 (a) continued to use the references to taxes imposed by subsections (a) and (b) of the tax imposing section. In so doing, the refund section, in effect, covered what had previously been three subsections, (a), (b), and (c), (c) being the subsection in the 1939 code referring to parts and accessories. This technical error provided for refunds which the Congress did not intentionally legislate.

Aside from the fact that the refund for automobile parts and accessories is unintentional, it appears undesirable from the point of view of administration and compliance. Unlike the taxes on alcoholic beverages, cigarettes, and gasoline, the automotive taxes are ad valorem rather than specific taxes. Consequently, when a dealer wishes to claim a credit or refund, he must determine, or have determined for him by the manufacturer, the amount of the tax that was paid on the sales price of the articles. This is no great problem in the case of large items, like automobiles and trucks, where each unit has a serial number. In the case of parts and accessories, however, the problem in many cases would seem almost impossible to solve except on an estimated basis. The tax covers literally hundreds of items, many of which are very small. Quite often the dealer has bought such parts at different times from wholesalers and has no way of identifying at what time the various articles were bought, or even the manufacturer. Much of the burden of computation would fall upon the manufacturers who would probably end up by making estimates, and in some cases by simply refusing to try to determine the information requested. Consequently, it is suggested that this provision be deleted.

4. *Sugar.*—The refund provision for taxpaid imported sugar or imported products composed in chief value of manufactured sugar when held by the importer and intended for sale contains no specified time limit as to when claims for refund should be filed. This requirement would be handled by the regulations. If the filing of floor stocks refunds for other taxes is to be based on statutory time limits, there seems to be no reason why this refund should not be so regulated.

5. *Alcoholic beverages and cigarettes.*—The refund provisions for alcoholic beverages and cigarettes require claimants to keep such records of inventories, sales, and purchases as may be prescribed by the Secretary or his delegate for a time both before and after the tax reduction date (but not extending beyond 1 year thereafter). In the case of cigarettes, this provision was inserted in 1951 to make it com-

parable with the requirement existing since 1945 in the case of alcoholic beverages. The alcoholic beverage provision was first inserted in 1945 in conjunction with the requirement that there be proof of price reductions to reflect the proposed refunds (a price reduction provision now exists only in connection with the refund provision for gasoline). But the price reduction provision for alcoholic beverages and cigarettes was eliminated at the time of the enactment of the 1954 code. Therefore, there appears to be no need for the retention of the recordkeeping provisions with respect to sales and purchases; the general requirement as to inventory data in the refund provisions for manufacturers' excises should be sufficient.

PART 3: ADJUSTMENT OF PRICE ON SALES TO SELLING SUBSIDIARY

Section 4216 (b) of the Internal Revenue Code of 1954 provides that if an article is—

(1) sold at retail (i. e., to a consumer),

(2) sold on consignment, or

(3) sold (otherwise than through an arm's length transaction) at less than fair market price,

tax is to be computed on the price for which the articles are sold by the manufacturers in the ordinary course of trade as determined by the Secretary or his delegate.

The Internal Revenue Service has taken the position that a sale to a selling subsidiary is presumed to be not at arm's length. It is recommended that the law be amended to include this presumption.