1963

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RULINGS PROGRAM—BACKGROUND

In 1963, the tenth year of the Service's broadened ruling publication program, some 300 rulings were published. These pronouncements by the Service represent rulings, procedures, instructions or other communications involving substantive tax law or procedures affecting taxpayers' rights or duties.[1] Since it is the stated policy of the Service that taxpayers may rely upon rulings published in the Internal Revenue Bulletin —whenever "the facts and circumstances are substantially the same" as the published ruling[2]—analysis of the key Service rulings becomes an important part of tax practice.

KEY INDIVIDUAL RULINGS

Revenue Rulings 63-20[3] deals with obligations issued by a non-profit corporation formed under state law to stimulate industrial development in a political subdivision of a state. Under section 103 of the Code, interest on the obligations of a state or its political subdivision are excluded from gross income. The regulations[4] provide that the issuance of obligations "on behalf of a state or its political subdivision" are also within the ambit of section 103. In the light of the increased use of the nonprofit industrial development corporation, the ruling focuses on when the obligations of such an entity are issued "on behalf of" a political subdivision.

Rev. Rul. 63-20 describes five conditions which must be met before interest on the corporate obligations will be considered excludible from gross income:

[1]See statement of ruling policy, Rev Rul 2, 1953-1 C.B. 484 and Rev Rul 212, 1953-2 C.B. 499. Early land marks in formulating a publication program are found in Sen. Couzens' 1925 investigation of the Bureau (S. Rep. 27, Part I, 69th Cong., 1st Sess.); the 1941 Attorney General's Committee on Administrative Procedure (S. Doc No. 10, Part 9, 77th Cong., 1st Sess.); and the 1953 inquiry into Service ruling policy and practice. (Report to the Subcommittee of the Committee on Ways and Means by the Subcommittee on Administration of the Internal Revenue Laws, 1953)

[2]Rev Proc 62-28, Section 13.09, 1962-2 C.B. 496, superseding Rev Rul 54-172 Section 12.06, 1954-1 C.B. 401.

[3]1963-1 C.B. 24

[4]Reg. section 1.103-1

(1) The corporation must engage in activities essentially of a public nature; (2) The corporation must not be organized for profit except to the extent of retiring indebtedness; (3) The corporation income must not inure to the benefit of any private person; (4) The political subdivision must have a beneficial interest in the corporation while the indebtedness is outstanding and will obtain full legal title to the property at the retirement of the indebtedness; and (5) The political subdivision must approve the corporation as well as the obligations.

Revenue Ruling 63-64[5] is an outgrowth of the Berlin crisis of 1961 and deals with travel expenses. Under Public Law 87-117 the President is authorized to order units of the Ready Reserve to active duty for not more than one year. Since some reservists did not abandon their private business and others will return to their prior employment the question arose as to the deductibility of travel, meals and lodging while on active duty. The problem was further heightened in that many reservists received basic subsistence and quarters allowances. Two questions are answered by the ruling: (1) Is a member of the Ready Reserve in a travel status where he has not abandoned his civilian place of business or employment; and if so (2) are his expenditures for meals and lodging deductible while on temporary duty, i.e., where they exceed the reservist's subsistence and quarters allowance.

Under Rev. Rul. 60-189[6] the general rule was established that employment away from home under an actual or anticipated duration of less than one year is normally regarded as being of a temporary character. Since temporary employment away from a principal or regular place of duty puts the taxpayer in a travel status, the reservists who, in effect, intends to return to his civilian business upon his release is in travel status. Therefore, the reservists in this situation would be entitled to a deduction for the expenditures made for meals and lodging, with two limitations. First, the deduction would initially be off-set by the non-taxable quarters and subsistence allowance received. And second, his expenses are limited to those directly attributable to his presence on the military post. This latter caveat carves out expenses of the family he might have brought with him to camp.

Revenue Ruling 63-77[7] concerns another travel expense problem: whether payments or reimbursements by a prospective employer of expenses incurred in connection with interviews are wages as far as the prospective employee is concerned and whether the employer must withhold or pay employment taxes. The type of expense involved are generally the meals, lodging and round-trip transportation of the prospective employee, normally to the main office of the employer.

Based on the lack of an employment relationship, the ruling holds,

[5] 1963-1 C.B. 30
[6] 1960-1 C.B. 60
[7] 1963-1 C.B. 177

with respect to the employment taxes and the withholding by the employer, the reimbursements are not wages. The reimbursements are also excludable from gross income of the employee. This conclusion, that the expenses are those of the prospective employer rather than the employee, is supported by earlier rulings. Rev. Rul. 55-555,[8] (dealing with reimbursed car-pool expenses); I. T. 4068,[9] (where a child-placement agency paid the expenses of the placement of a child in a foster home); Rev. Rul. 57-60,[10] (a state kindergarten mileage law paid parents for transporting their children). It is worth noting the facts ruled on indicate the employee came to the interview at the invitation of the employer under an agreement that the employer would pay the expenses.

In *Rev. Rul. 63-91,*[11] the Service concerned itself with an unusual facet of the medical expense deduction. This ruling holds that amounts paid to a practitioner, such as a chiropractor, for treatment constitutes "medical care" even though the practitioner is not licensed, certified or otherwise qualified to perform the treatment.

The need for this interpretative position arose because the regulations[12] under section 213 provide "amounts expended for illegal operations are not deductible" and three published rulings implied a practitioner must be qualified, authorized or licensed to practice his profession. While the regulations under section 213 are interpreted in this ruling to disallow expenses for operations or treatments that are illegal (e.g., an abortion), regardless of whether performed by a licensed practitioner, the ruling is not intended to imply that amounts paid to an unlicensed practitioner for "medical care" are not deductible. There is no requirement in the Code or regulations that the taxpayer ascertain whether a practitioner is licensed or not before obtaining his services. The ruling is intended to dispel any implication to the contrary.

Rev. Rul. 63-250[13] concerns the disposition of pending cases under section 117 relating to the exclusion from gross income for scholarships and fellowship grants where the facts are substantially identical to the *Bhalla* or *Spruch* cases.[14] In these cases, the Tax Court held the stipends received through university research programs, were primarily to further the education and training of the taxpayers, hence excludible from income under section 117. In both cases the taxpayers were candidates for Ph.D. degrees in physics and the research conducted for their grant was also in satisfaction of the degree requirement. Furthermore, equivalent research was required for other degree candidates within the school.

[8] 1955-2 C.B. 20
[9] 1952-1 C.B. 7
[10] 1957-1 C.B. 25
[11] 1963-1 C.B. 54
[12] Reg. Section 1.213-1(e)(ii)
[13] I.R.B. 1963-48,9
[14] 35 T.C. 13; 20 TCM 324.

The ruling points out that further study is being made by Treasury of the section 117 area and if the regulations issued are more restrictive, they will be prospective in application.

CORPORATE RULINGS

Rev. Rul. 63-63[15] concerns the effect of the new investment credit on the computation of earnings and profits. Under section 38 of the Code the credit against income tax is provided for investment in certain types of new or used depreciable property for the taxable year in which the property is placed in service. Section 48 provides for an adjustment to the basis of the property in order to reflect the credit. The result is a reduction in income tax liability by the amount of the credit, thus providing the corporation with funds that otherwise would not be available. When there is an early disposition of the section 38 property, section 47 provides for an addition to the tax of a portion or all of the original credit for the year of the disposition.

The ruling holds that under these circumstances it would be inappropriate in computing the earnings and profits to allow as a decrease thereto, the gross amount of the income tax liability before reduction by the amount of the investment credit. Similarly, the adjustment to basis required by section 48 for the year the property is placed into service may not be reflected as a reduction in earnings and profits that year.[16]

Rev. Rul. 63-104[17] concerns the effect of a bankruptcy of an affiliate on the filing of a consolidated return. The ruling holds that if an affiliated group is required to file a consolidated return for any taxable year, the return must include the income or loss of the members adjudicated bankrupt even though the trustee in bankruptcy refuses or fails to file the consent form for the year. This would also seem to follow if there is a receivership rather than a bankruptcy. In the case of a bankruptcy or receivership, the court-appointed receiver or trustee may choose, because of one reason or another, not to join the affiliated group. Normally he has got the losses and the rest of the group want them—thus, the refusal to file a consolidated return. In effect the ruling says his failure or refusal to file a consent is no ground for not filing the consolidated return.

Rev. Rul. 63-114[18] helps to construe one of the more difficult terms

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15 1963-1 C.B. 10

16 U.S. Tax Week (3-8-63) predicts "considerable discussion and litigation" regarding this position. The argument raised is that the benefit of section 38 is tied into the detriment of the section 48(g) loss in basis—it would therefore be improper to include the subsidy (the credit) in earnings and profits.

17 1963-1 C.B. 172

18 1963-1 C.B. 74

in the collapsible corporation area; the word "construction." The term is used in a number of places in section 341 and its meaning assumes essential importance when, as here, a corporation has clearly engaged in the "construction" of property in the past and now wants to know when it has ceased such "construction." Section 341(d)(3) provides that collapsible treatment does not apply in the case of gain realized after the expiration of the three years following the completion of "construction". The question then is when does "construction" cease?

Since this is a highly factual question, the revenue ruling should be examined closely with great care as to the facts. The facts in the ruling indicate N corporation was clearly formed for the principal purpose of erecting and owning an office building. It began construction in 1957 and by the end of 1958 the building was completely erected, leased and occupied. During the next three years N incurred "construction type expenses." The ruling examines the post-1958 expenses to determine whether they constitute the continuation of old construction, new construction or something else. Significantly, the stated facts are that the post-1958 expenditures were relatively insignificant when compared to the entire building. The ruling concludes that the character of the building was not changed, the rental area was not increased; nor the fair market value appreciably increased.

On these facts it was held the expenditures were made merely for the purpose of modifying or altering existing property. The building in effect was completed not later than December 31, 1958, and the expenditures were not made for "construction" of property within the meaning of section 341.

Rev. Rul. 63-118[19] deals with the effect of interest from non-taxables on the preferred position of a regulated investment company. To obtain the conduit treatment offered under section 851, a regulated investment company, among other requirements, must: (a) derive at least 90% of its gross income from dividends, interest and gains from the sale of stock or securities; and, (b) less than 30% of gross income must be derived from the sale of stock or securities held less than three months. In some situations a corporation could qualify as a regulated investment company if it were permitted to off-set gains with losses and include as gross income, tax exempt interest. The ruling holds that gross income includes gross gains undiminished by losses. Further, tax exempt interest cannot be included in gross income.

As to the first holding, the losses of the regulated investment company are irrelevant to whether there has been speculative activity of the kind discouraged by section 851(b)(3). The allowing of the losses to be off-set against the gains as requested by the taxpayer in the ruling

[19] 1963-1 C.B. 121

would run counter to this policy. As to the second holding, gross income is not defined under section 851 or in the Investment Company Act of 1940. In the absence of a specific definition, the ruling reverts back to section 61 to define gross income. Under section 61, "gross income . . . except as otherwise provided . . . means all income from whatever source derived." One exception, section 103, is to the effect that gross income does not include the interest on municipal obligations. Consonant with this position the Service has held[20] tax exempt interest excludable from the gross income of a corporation for the purposes of qualifying as a Western Hemisphere trade corporation.

Rev. Rul. 63-127[21] dwells on the question of elections under section 1033. This ruling deals with a taxpayer who paid the tax on gain realized from an involuntary conversion and then reinvested the proceeds in replacement property within the period when he could qualify for nonrecognition of the gain under section 1033(a)(3).

In the example: 1960 the taxpayer sold a parcel of land under the threat of condemnation and received the entire proceeds that year. In the same year he reinvested a portion of what he received in replacement property. On his 1960 return the taxpayer reports gain and pays the tax on the excess between the cost of the replacement property and his sales price. In 1961 the taxpayer decides to make an election under section 1033(a)(3) with respect to the unexpended portion and reinvests this in replacement property. On his 1961 return all of this is spelled out and he files a claim for refund for the amount paid in 1960. The ruling holds that the benefits of section 1033(a)(3) are available to the taxpayer on the basis of the claim for refund filed *after the expiration of the replacement period, but before the expiration of the period of limitation for the assessment of the tax for the year in which the gain was realized.* The regulations[22] provide for the filing of a claim if the decision to make an election under section 1033(a)(3) is made after the return is filed. No provision exists in that section to provide guidance as to what constitutes an election or as to when the election occurs. The ruling states, as a matter of fact, the taxpayer decided to make the election under section 1033(a)(3) and reinvest the proceeds in replacement property. The implication is timely reinvestment itself amounts to the section 1033(a)(3) election.

ESTATE AND GIFT TAX

In June of 1962 a notice of proposed rule making was published to the effect that replacement cost was the measure for estate and gift

[20]Rev Rul 57-435, 1957-1 C.B. 462
[21]IRB 1963-27, 10
[22]Reg. section 1.1033(a)-2 (c)(2)

tax valuation of mutual funds. There were hearings in the fall of 1962 and the final regulations have been published.[23]

A mutual fund or open end investment company sells stock in itself. Generally the public purchases the stock of an open end investment company at a price determined by the fractional value of the funds net assets, plus the load charge, (the expense of marketing the shares.) The mutual fund receives the net asset value of each share sold. A shareholder may redeem at the net asset value or "bid price" from the mutual fund at any time, normally only however from the fund itself. Originally the regulations under the 1954 Code had no provision regarding the valuation of mutual funds. Without any regulations or rulings in this area there was no uniformity and some districts apparently were using "bid price" as the quantum of value of the mutual fund shares, others were using the "ask price," and still others found that the mean between the two was the appropriate figure for valuation. The general valuation principle involved throughout the estate and gift tax area to determine fair market value is the willing buyer and the willing seller concept. The willing buyer rule acknowledges an asset can have a value in excess of liquidation value. In the case of the mutual fund this would be the loan price.

The regulations equate the fair market value as including this loan price. This is in line with, for example, the result where real estate is sold. The value of the real estate is not diminished by the commissions paid to the real estate agent. Similarly, when common stock is sold the value of the stock is not lessened by the expenses of the seller. The mutual fund charge is not an acquisition expense, but rather it is a part of the price of the shares representing the selling expenses of the mutual fund itself.[24]

CONCLUSION

This then was the year that was.

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[23]Reg. section 20.2031-2, 8 and section 25.2512-6

[24]Support for the use of "asked price" can be found, for example, in Baltimore Nat. Bank v. U.S. (D. Ct. 1955) 136 Fed. Supp. 642 (where securities retained for appreciation or sold at sacrifice are valued in excess of liquidation value) and Publicker v. Commissioner, (CA 3 1953) 206 F. 2d 250, cert. den. 346 U.S. 924, (included in valuation of jewelry the federal excise on retailers.)