PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, London, England

DATE: September 10, 1940, 5 p.m.

NO.: 3051

FOR TREASURY FROM BUTTERWORTH.

The extent to which London has been damaged by air raids no doubt vitiates the announcement of the Prime Minister on the fifth of September that the British Government would reconsider its previous refusal to become a party to any scheme for insurance of property against damage from air raids. Such an insurance plan has always been opposed by Phillips as being impossible to carry out.

Today in the City there is not much business moving except to clear away debris - incidentally, some of the debris has been produced by one direct hit on the Bank of England and one indirect hit on that structure.

KENNEDY.

EA:LWW

TELEGRAM SENT GRAY

HSM

September 10, 1940

11 a. m.

AMEMBASSY

VICHY

1170.

FROM THE TREASURY FOR MATTHEWS.

Reference your 512, September 6, 9 p. m.

Please communicate the following to Robert E. Pearce, National City Bank France, Paris, from Sheperd, National City Bank, New York:

QUOTE Very much interested your cable relative to disposition of French business and personnel and fully agree in principle but need your recommendation as to procedure. Should we sell ownership of National City Bank France or should latter sell its assets having in mind tax and other costs as well as institutional relationship toward clients who have preferred American connection? Buyers are not to use our name in any event. Suggest close consultation Vanson. Would strongly prefer sale to one of our closer bank friends and if possible all cash but in any event no board representation. Agree building and bank premises to be considered separately. END QUOTE.

HULL
(HF)

EA:FL:LWW

Rec'd 9/10/40

September 9th, 1940

SPAIN AND PORTUGAL

The following reply has now been received from London to Sir Andrew Agnew's inquiries regarding the question of oil for Spain and Portugal:-

1. We much appreciate Mr. Morgenthau's help in this matter and hope that an explanation of the situation in Spain and Portugal will indicate that we have not been too lenient in the matter of oil supplies for these countries.

2. In fact, since August 1st we have applied very drastic measures of control to all the imports of these countries by threatening to seize all ships carrying anything for them which has not been approved by us (i.e. navicerted). One result of this has been that sailings of tankers carrying oil for Spain since August 1st have been severely curtailed and that, instead of the large threatened increase in Spanish stocks of oil taking place, we have, with the help of measures taken by the United States Government, reduced these stocks from 217,000 tons on August 1st to about 180,000 tons at the beginning of September. It is estimated that stocks will be further reduced by October 1st to 146,000 tons, unless we allow the Spaniards to charter one or more non-Spanish tankers.

3. These measures have naturally aroused resentment in Spain and we cannot in fact rebut a charge that they constitute something like an unfriendly act unless we can show that we intend to allow sufficient imports for internal consumption in Spain.

4. The Fascist Falange Party are working to bring Spain into the war against us. General Franco is in favour of neutrality but the balance is still fairly even. We are all the more determined to prevent the accumulation of stocks in Spain, but hope to do so without precipitating a crisis unfavourable to us.

5. In view of the apparent situation about Spanish oil stocks and consumption, Mr. Turner was sent to Spain to make inquiries on the spot. He has satisfied himself on both points and has now been authorized to conclude an agreement with the Spaniards under which their oil stocks will be fixed at 160,000 tons (instead of the figure of 187,500 tons previously mentioned) of all products, with special limitations for lubricating oils and aviation spirit. Under the restrictions imposed by the Spanish Government on the use of gasoline in Spain, the present consumption is 63,000 tons a month. The stock figure of 160,000 tons therefore represents approximately 2½ months' supply on the basis of this rate of consumption. The Spanish authorities are unwilling at present to remove the restrictions on the use of gasoline, owing to a shortage of foreign exchange.

6. Our /

TO THE SECRETARY
OFFICE OF THE

6. Our original intention had been to fix stocks at two months' supply but (a) we are advised that 150,000 tons would be the minimum stock on which a country as large and as badly equipped with transport as Spain could reasonably be expected to operate; and (b) a slight concession was necessary and was considered worth while in order to reach an agreement. Therefore, the figure of 160,000 tons was decided upon and, amongst other conditions, we are requiring assurances that no oil imported through our controls be supplied for use by enemy civilian aircraft.

7. Imports into Spain will be limited by means of navicerts so as to keep stock figures down to the agreed level. We are satisfied that this level will not allow re-export to Germany of any important quantity of oil without causing a serious shortage and dislocation in Spain and we will, of course, watch closely for any breach of the Spanish guarantee not to re-export.

8. With regard to Portugal, detailed discussions regarding imports of oil into Portugal will be undertaken by Mr. Turner in Lisbon when he has finished his negotiations in Madrid. We propose, as in the case of Spain, to limit imports to current requirements and to fix stocks at a reasonably low figure (the present stocks in Portugal are provisionally estimated not to exceed two or three months' supply). In view of the friendly relations between Great Britain and Portugal and as Portugal is likely to co-operate insofar as she can be given military support, our attitude would be to treat her no more stringently than Spain, especially as the quantities of oil involved in her case are comparatively small.

September 9th, 1940

Notes on Spanish memorandum
dated September 9th, 1940

1. In connection with London's reply to Mr. Morgenthau's inquiry regarding Spain, it should be noted that London's proposals envisage the use of non-Spanish tankers because the current consumption of Spain at the level of 63,000 tons per month exceeds the carrying capacity of the Spanish tanker fleet, which is 42,000 tons per month.

2. The State Department have been kept fully informed on the question of oil for Spain and of London's proposals. The State Department have expressed no objection to the use of non-Spanish tankers and are prepared to allow U. S. flag vessels to go, provided that we give the U. S. Government some assurance that these vessels will not be diverted into control ports. This, in practice, means that they will not allow U. S. vessels to go unless they are fully navicerted. The State Department's views were made known to London before the conversations between Mr. Morgenthau and Sir Andrew Agnew took place, and it is possible that Mr. Morgenthau may not be aware of the steps which have been taken.

3. Since the conversations between Mr. Morgenthau and Sir Andrew Agnew, Mr. Turner in Madrid has been authorized to agree that Spanish stocks should be fixed at 160,000 tons, instead of at 187,500 tons which had previously been proposed. However, non-Spanish tankers will still be required to provide for current consumption after this stock level has been reached. Imports will be limited by means of navicerts so as to keep stocks down to the agreed level, but the whole scheme for the use of non-Spanish tankers rests upon the British view that, for political reasons, Spain should be allowed to import at a rate which will maintain their stocks at a figure not exceeding 160,000 tons.

4. It should be realized that the regular petroleum trade with Spain is very largely in the hands of American oil companies and that whatever supplies are permitted to go forward, these will be shipped mainly by American companies, and it is reasonable that these American companies should use their own vessels, whether under the U. S. or other flags.

5. Portugal has no tanker fleet and, under similar safeguards in regard to stocks and current consumption, it willbe necessary for the oil companies to provide tankers for this trade. The Shell Company has a position in Portugal but will, of course, be subject to similar restrictions.

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PH:MS

CONFIDENTIAL

September 9th, 1940

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CONFIDENTIAL

143

September 10, 1940

My dear Mr. President:

The aviation manufacturing industry has furnished us each month, on a strictly confidential basis, the number of employees in each individual factory. My agreement with them is that I will not show these figures to anybody except the President of the United States.

However, the increase in the number of employees is so impressive that I thought you might want to use it and nothing in my agreement with the industry would keep you from giving out the total figures involved.

I would like to draw your particular attention to the fact that in December, 1938, the aggregate number of employees was 31,200; in December, 1939, it was 65,400, and in August, 1940, 110,400.

This seems to me to tell the story of the growth in the aviation industry better than any figures that have yet come to my attention.

Yours sincerely,

(Signed) H. Morgenthau, Jr.

The President,

The White House.

Enes.

By Messenger 405

CONFIDENTIAL

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copied on 143,144

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By Messenger

CONFIDENTIAL

September 9, 1940.

Secretary Morgenthau

STRICTLY CONFIDENTIAL

Mr. Haas

Subject: Employment in the Aviation Manufacturing Industry

1. Employment in the aviation manufacturing industry has increased by approximately 70 percent since the end of last year. In August 1940, manufacturers of airplanes employed 83,800 factory workers and manufacturers of airplane engines approximately 26,600 factory workers, a grand total of 110,400 factory workers for the entire industry. In December 1939, the aggregate employment was 65,400.

2. Proportionally, the greatest increase in employment has taken place in the airplane engine plants, where the number of factory workers employed in August 1940 was more than double the number employed in December 1939. The largest increase took place at the Allison Engineering Company where employment has multiplied five times (to 4,600) since the end of last year.

3. The August increase in employment was distributed among practically all of the manufacturers in the industry. The largest increase in employment -- approximately 1,700 employees -- occurred at the Glenn L. Martin Company. This brought the employment at the Martin plant back to the peak levels that existed at the end of last year.

4. In recent months Curtiss-Wright (including its subsidiary Wright Aeronautical Corporation) has displaced the Douglas Aircraft Company as the largest single employer in industry. In August, the Curtiss corporations employed 16,748 factory workers and Douglas had 14,898. The United Aircraft Corporation (including its Pratt & Whitney division) was the third largest employer, with 14,465 employees.

5. The attached chart shows total employment in the aviation manufacturing industry and the employment of selected companies since January 1937. The attached tables give the figures plotted on the chart.

Attachments

Employment in Aviation Manufacturing Industry
(Airplanes and Airplane Engines)

1937-1940

	1937	1938	1939	1940
Airplanes				
Jan.	22,100	23,700	25,000	56,800
Feb.				57,200
Mar.	24,100	24,200	27,400	58,700
Apr.				60,600
May				65,200
June	25,200	22,800	36,500	70,300
July				77,500
Aug.				83,800
Sept.	23,400	21,700	41,100	
Dec.	23,800	24,100	52,800	
Airplane Engines				
Jan.	5,500	6,500	7,300	13,700
Feb.				15,600
Mar.	6,000	6,600	8,100	17,100
Apr.				18,400
May				20,500
June	6,600	6,900	8,900	22,600
July				24,900
Aug.				26,600
Sept.	6,400	7,000	9,500	
Dec.	6,600	7,100	12,600	
Total Industry -- Airplanes and Airplane Engines				
Jan.	27,600	30,200	32,300	70,500
Feb.				72,800
Mar.	30,100	30,800	35,500	75,800
Apr.				79,000
May				85,700
June	31,800	29,700	45,400	92,900
July				102,400
Aug.				110,400
Sept.	29,800	28,700	50,600	
Dec.	30,400	31,200	65,400	

Office of the Secretary of the Treasury,
Division of Research and Statistics. September 6, 1940.

Employment of Selected Aircraft Manufacturing Corporations

1937-1940

	1937	1938	1939	1940
Bell Aircraft Corp.				
Jan.	615	222	654	859
Feb.				865
Mar.	850	290	912	896
Apr.				840
May				873
June	808	440	1,410	1,192
July				1,480
Aug.				1,963
Sept.	718	235	703	
Dec.	213	606	799	
Boeing Aircraft Co.				
Jan.	1,834	1,493	2,666	5,567
Feb.				5,445
Mar.	1,726	1,742	3,016	5,319
Apr.				4,776
May				5,785
June	1,249	1,836	3,374	6,513
July				7,313
Aug.				7,910
Sept.	1,109	1,948	4,468	
Dec.	1,380	2,485	5,199	
Consolidated Aircraft Corp.				
Jan.	3,169	2,540	968	2,837
Feb.				3,477
Mar.	3,246	2,518	819	3,807
Apr.				4,349
May				5,040
June	3,099	2,104	832	5,821
July				6,743
Aug.				7,836
Sept.	2,617	989	1,408	
Dec.	2,580	981	2,540	

Employment of Selected Aircraft Manufacturing Corporations
1937-1940
(continued)

	1937	1938	1939	1940
Curtiss-Wright Corp. (excluding Wright Aeronautical Corp.)				
Jan.	1,241	2,211	3,802	4,380
Feb.				4,744
Mar.	1,500	2,347	2,939	5,016
Apr.				5,213
May				5,698
June	1,933	2,310	2,848	6,314
July				6,531
Aug.				6,597
Sept.	2,202	2,736	1,562	
Dec.	2,007	3,491	3,447	
Douglas Aircraft Co., Inc.				
Jan.	5,591	6,328	4,334	11,952
Feb.				12,077
Mar.	5,961	6,173	4,177	13,119
Apr.				14,033
May				14,656
June	6,653	4,672	5,445	14,957
July				14,662
Aug.				14,898
Sept.	5,532	4,028	6,318	
Dec.	6,771	4,110	10,362	
Lockheed Aircraft Corp.				
Jan.	910	1,577	2,305	5,157
Feb.				4,768
Mar.	1,094	1,594	3,509	4,362
Apr.				4,400
May				5,016
June	1,338	1,797	5,699	5,591
July				6,599
Aug.				7,296
Sept.	1,383	1,997	5,324	
Dec.	1,428	2,123	5,156	

Employment of Selected Aircraft Manufacturing Corporations
1937-1940
(continued)

	1937	1938	1939	1940
Glenn L. Martin Co.				
Jan.	1,364	1,814	2,905	10,984
Feb.				9,407
Mar.	1,716	1,892	4,092	9,133
Apr.				9,010
May				9,357
June	2,044	2,134	6,029	9,133
July				9,513
Aug.				11,200
Sept.	2,032	2,341	10,070	
Dec.	1,818	2,777	11,174	
North American Aviation, Inc.				
Jan.	829	1,713	2,223	4,049
Feb.				4,324
Mar.	889	1,935	2,457	4,154
Apr.				4,371
May				4,336
June	841	2,400	3,125	4,782
July				4,918
Aug.				4,916
Sept.	1,272	2,685	2,992	
Dec.	566	2,530	3,795	
United Aircraft Corp. (excluding Pratt & Whitney)				
Jan.	2,350	2,245	1,826	2,757
Feb.				3,051
Mar.	2,444	2,168	1,766	3,468
Apr.				3,735
May				3,912
June	2,497	1,972	1,952	4,282
July				4,823
Aug.				5,016
Sept.	2,439	1,880	2,123	
Dec.	2,338	1,774	2,588	

Employment of Selected Aircraft Manufacturing Corporations
1937-1940
(continued)

	1937	1938	1939	1940
Vultee Aircraft, Inc.				
Jan.			364	742
Feb.				938
Mar.			440	959
Apr.				1,008
May				1,334
June		560	533	2,127
July				2,618
Aug.				
Sept.		430	288	2,857
Dec.		334	662	

Employment of Selected Airplane Engine Corporations

1937-1940

	1937	1938	1939	1940
Allison Engineering Co.				
Jan.	218	262	454	1,114
Feb.				1,261
Mar.	229	297	466	1,610
Apr.				1,958
May				2,766
June	238	339	558	3,254
July				3,917
Aug.				4,595
Sept.	238	382	642	
Dec.	266	439	901	
Continental Motors Corp. (Airplane Engine Division)				
Jan.	151	153	134	288
Feb.				344
Mar.	153	152	138	358
Apr.				368
May				378
June	162	144	171	388
July				398
Aug.				382
Sept.	135	146	203	
Dec.	152	142	243	
Lycoming Division of Aviation Manufacturing Corp.				
Jan.	849	729	519	581
Feb.				638
Mar.	889	704	521	657
Apr.				711
May				765
June	901	549	573	819
July				873
Aug.				970
Sept.	756	514	644	
Dec.	762	506	689	

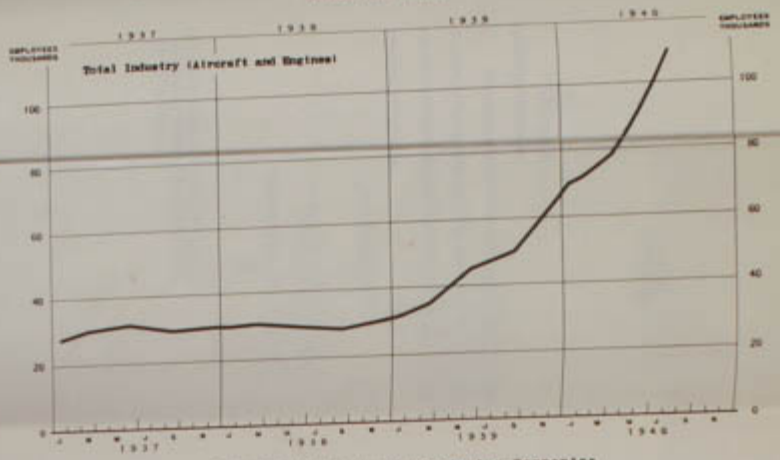
Employment of Selected Airplane Engine Corporations
1937-1940
(continued)

	1937	1938	1939	1940
Pratt & Whitney Aircraft				
Jan.	1,931	2,567	2,264	5,642
Feb.				6,549
Mar.	2,119	2,489	2,659	7,158
Apr.				7,541
May				7,765
June	2,384	2,555	3,066	8,504
July				9,121
Aug.				9,449
Sept.	2,471	2,384	3,394	
Dec.	2,618	2,227	5,022	
Wright Aeronautical Corp.				
Jan.	2,254	2,607	3,398	5,411
Feb.				6,081
Mar.	2,515	2,705	3,771	6,537
Apr.				6,984
May				7,882
June	2,800	2,930	3,997	8,682
July				9,491
Aug.				10,151
Sept.	2,690	3,184	4,026	
Dec.	2,608	3,374	5,141	

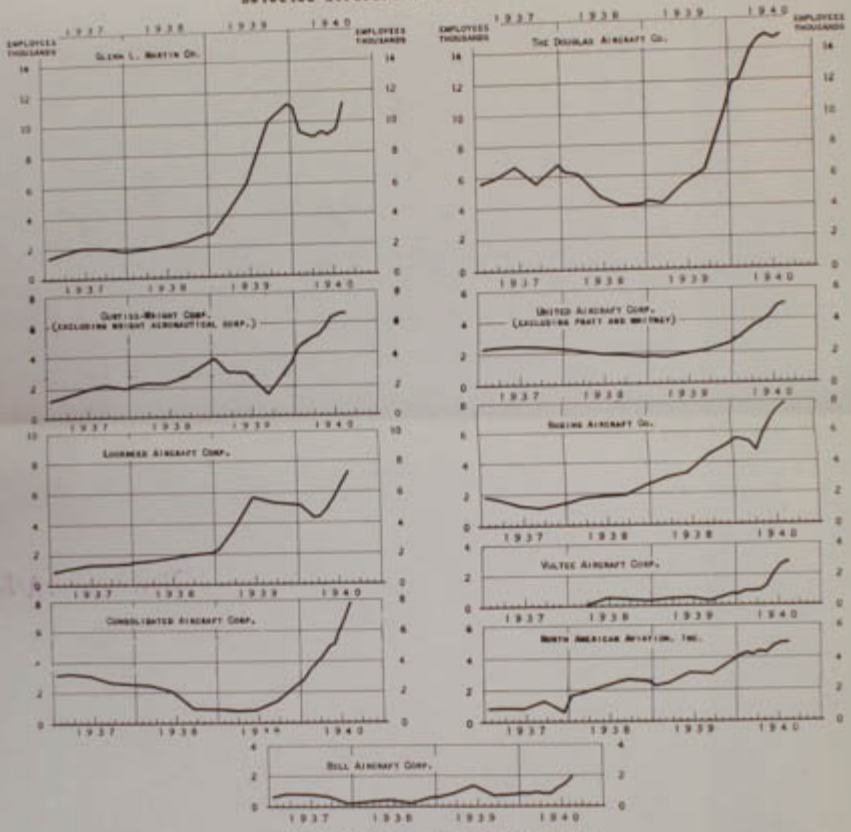
STRICTLY CONFIDENTIAL

EMPLOYMENT IN AVIATION MANUFACTURING INDUSTRY

Factory Wage Earners



Selected Aircraft Manufacturing Companies



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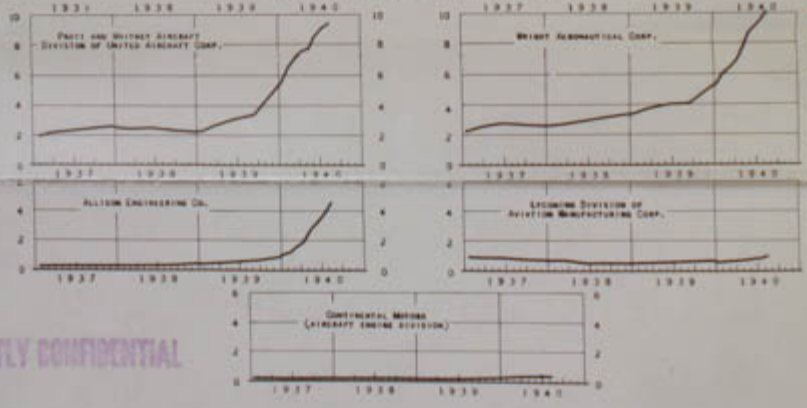

STRICTLY CONFIDENTIAL

Office of the Secretary of the Treasury
Division of Research and Statistics

1 - 10A - 2

154

September 10, 1940

George

Dear ~~Mr. Harrison:~~

When you are in Washington will you call on Mr. Chamberlain, who will be glad to talk over with you the question of remittances for relief in the occupied countries.

Sincerely yours,

(Signed) H. Morgenthau, Jr.

Secretary of the Treasury

Mr. George L. Harrison, President,
Federal Reserve Bank of New York
New York City

JPC:jmc J.P.C.

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New York City

JPC:jmc

304: 160

FEDERAL RESERVE BANK
OF NEW YORK

August 29, 1940.

Dear Secretary Morgenthau:

The Executive Order of the President, dated April 10, 1940, blocking funds held in this country for account of nationals of Norway and Denmark, following the invasion of those countries by Germany, and later amendments to that Order extending it to funds belonging to nationals of other countries invaded by Germany or Russia, were, as I understand it, primarily motivated by a desire to protect these funds from the possibility of misappropriation by the invaders through coercion or duress. Generally speaking, these Orders at the time of their promulgation were favorably received throughout this country as well as in the invaded countries. Numerous problems incident to the handling of applications for licenses to make payments out of these accounts have, of course, arisen from time to time and some of them are still pending decision by the Treasury. That is quite understandable in view of the complexities involved.

My purpose in writing to you now is to call to your attention only one of these problems which I do not believe can be of importance from a national or international point of view and which, according to my best information, is causing much comment and increasing criticism. I know that you will understand the spirit in which this letter is sent and accept my comments in that same spirit.

This is the problem: Many American nationals resident in this country have for one reason or another desired to remit varying sums of money to relatives, friends or others in dire distress in occupied territories. Under the terms of the Presidential Order these remittances cannot be made except by license of the Treasury. While no definite policy for handling these applications has been announced by the Treasury, the overwhelming majority of them have not been approved and many hundreds are now before the Treasury awaiting action.

The failure of the Treasury to approve these applications is, I believe, a matter of growing resentment and complaint. It is claimed by the applicants and, I think rightly, that the money in question is their own; that there is no possibility of coercion or duress as respects their attempted transfers for charitable or other legitimate purposes; and that their case is very different from that of nationals of occupied countries whose funds in the United States might be dissipated without their free consent were it not for the Executive Order. The only apparent reason for the failure to grant these applications by Americans who freely want to send their own money into occupied territories is a desire on the part of the Treasury - far beyond what I have assumed to be the purpose of the original Order - to make sure that the dollar exchange resulting from such transfers will not come into German hands. This does not seem to me to be an adequate reason. In the first place, the amounts involved are relatively small. More important, however, is the obvious inconsistency in refusing transfers of this sort to destitute persons in occupied territory when there is

no bar to the transfer of unlimited sums from this country to persons located in Germany or Russia.

If the Treasury wishes to hold up remittances to occupied territories solely on the ground that it does not want Germany (or other invading countries) to get the resulting dollar exchange, (and I cannot see any warrant for that short of the need for a complete embargo for public reasons) is there any logic in permitting transfers to be made direct to Germany itself? Please do not infer from this that I favor a prohibition on transfers by our own nationals of their own moneys to Germany for any legitimate purpose. Rather, I mention the inconsistency in the hope that it will serve to recommend an early adoption by the Treasury of a policy which would permit of transfers to persons located in territories which are now occupied by Germany (or Russia) of the kind which I am discussing. The fact that Germany might incidentally get the resulting dollar exchange should not be controlling so long as we are not a belligerent.

Frankly, I fear that unless the rapidly increasing volume of applications now pending before the Treasury for transfers to persons resident in the occupied territories are acted upon favorably, or some convincing reason for contrary action is put forward, it may become difficult, if not impossible, for the Treasury to defend itself against just public criticism.

I went to Washington last week to present this suggestion to Mr. Bell, in your absence, believing that something ought to be done even before your return from your vacation. But after discussion with Mr. Bell, I suggested, and he agreed, that perhaps the

Harrison File J.R.C.

September 10, 1940.

MEMORANDUM FOR THE FILES:

The letter dated August 29, 1940 from President Harrison of the Federal Reserve Bank of New York to Secretary Morgenthau was a subject of discussion at several meetings of the Foreign Funds Control. It was decided by the committee to recommend the following course of action to the Secretary:

No written reply would be made to Governor Harrison. On some occasion when he is in Washington Professor Chamberlain would speak to him about the remittance problem. This memorandum would be put in the file so that the record would clearly show that the Department does not accept as complete Governor Harrison's characterization of the purpose of Executive Order No. 8389, as amended, or his statement of the reason for the Treasury's position on remittance applications.

BB
E.A.L.

Rec'd 9/10/40

Shipments of British Controlled Oil

On July 22nd Mr. Morgenthau and Mr. Sumner Welles asked Lord Lothian for figures of shipments of oil under British control from Venezuela, Colombia, the Persian Gulf and Haifa to (a) Spain, (b) Vladivostock, and (c) Japan, from January 1st, 1940 and for each of the three preceding years.

2. The figures in the attached table were received from London on August 5th, but further action was delayed pending Sir Andrew Agnew's arrival.

3. There are no shipments of British owned or controlled oil from Colombia. The Shell Company is developing production but the only companies exporting are (1) Socony-Vacuum and Texas Corporation who jointly own the Barco concession and (2) Tropical Oil Company, a Delaware corporation, which is a subsidiary of Imperial Oil of Canada, which in turn is a subsidiary of Standard of New Jersey.

4. Shipments from Trinidad are however included. It should be realized, however, that Trinidad, Venezuela, the Persian Gulf and Haifa are not the only sources of British owned or controlled oil (e.g., Peru, Ecuador, British Borneo, etc.)

5. Oil from Bahrein and Saudi Arabia in the Persian Gulf is, in fact, owned jointly by the Standard Oil Company of California and the Texas Corporation. Exports of oil from Bahrein are now controlled by license, those from Saudi Arabia should not, strictly speaking, be included in British controlled oil.

Sept: 10th 1940

TABLE

Shipments of British-controlled oil in tons

		1937	1938	1939	6 months 1940
A. to SPAIN					
from Venezuela		0	0	0	0
Iran		0	0	0	0
Bahrein		0	0	0	0
Saudi Arabia		0	0	0	0
Haifa		0	0	0	0
Trinidad		0	0	0	0
to CANARY ISLES (Spanish)					
from Venezuela	(* 1)	159,000	221,000	283,000	70,000
Iran		0	0	0	0
Bahrein	(* 2)	0	0	52,000	0
Saudi Arabia	(* 2)	0	0	0	42,000
Haifa	(* 3)	183,000	246,000	242,000	0
Trinidad	(* 1)	244,000	128,000	12,000	3,000
B. to VLADIVOSTOCK					
from Venezuela		0	0	0	0
Iran		0	0	0	0
Bahrein		0	0	0	0
Saudi Arabia		0	0	0	0
Haifa		0	0	0	0
Trinidad		0	0	0	0
C. to JAPAN					
from Venezuela		0	0	0	0
Iran	(* 4)	0	0	0	27,000
Bahrein	(* 2)	263,000	60,000	0	0
Saudi Arabia	(* 2)	0	0	0	30,000
Haifa		0	0	0	0
Trinidad		0	0	0	0

* 1 - Shipments from Venezuela and Trinidad to the Canary Isles were by Shell to their bunkering station at Las Palmas. Those from Venezuela are actually derived from Curacao and Aruba, although the crude oil originated in Venezuela. The only other shipments by this route are from Standard Oil Company of New Jersey, and have not been included.

* 2 - Oil from Bahrein and from Saudi Arabia is, in fact, owned jointly by the Standard Oil Company of California and the Texas Company. The shipments to the Canary Islands were to the Spanish refinery CEPSA at Teneriffe. Exports from Bahrein are now subject to license. Those from Saudi Arabia should not, strictly speaking, be included in British controlled oil.

* 3 - These shipments from Haifa were also to CEPSA in Teneriffe, the major part was American owned oil derived from Socony-Vacuum's share of Iraq production, the balance being occasional cargoes delivered by Shell. Deliveries from Haifa to Teneriffe have now been stopped by H.M.G. and Socony are substituting Colombian crude.

* 4 - The oil from Iran to Japan is part of a contract for 12 to 15 cargoes (120,000 to 150,000 tons) made by the Anglo-Iranian early in 1940 under pressure from the Shah. The next shipment of approximately 10,000 tons will take place in November.

Recd 9/10/40

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Telegram from London of September 9th.

~~Secret~~.

The average standard octane number for German aviation fuels examined so far has been 88. They have varied from 87 to 92 octane numbers being blended from a similar base of spirit. The octane number of base spirit has been from 70 to 72 and to achieve octane ~~valves~~ values 87 to 92 a high lead content has been added on the average of 5.5 c.c.s. lead per imperial gallon. The recent sample of captured fuel gave a ~~valve~~ value of 100; this is considered by the Petroleum Board to be captured British petrol. The octane number of the base spirit of this sample was 84 the 100 octane number achieved by the addition of only 3.9 c.c.s. of lead. An ME 109 brought down yesterday had marked on its fuselage the figure 100 in a triangle where the normal octane value 87 is found.

I will send you periodical reports but these cannot unfortunately be weekly for technical reasons.

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September 10, 1940
4:30 p.m.

RE EXCESS PROFITS TAX

Present: Mr. Bell
Mr. Gaston
Mr. Sullivan
Mr. Foley
Mr. White
Mrs. Klotz

H.M.Jr: The President of the United States today has approved - my God, this mustn't leak - that he is going to back the LaFollette Bill and LaFollette said in order to set the stage he wants Johnny "Hanes" Sullivan --

Gaston: I will help you, John.

H.M.Jr: Well, your name is Johnny. I just wanted to see how much fight there was left in the Sullivans.

Sullivan: There is that much left.

H.M.Jr: He must make a statement tomorrow in order to cut this Gordian knot that everything that Harris has done, the Treasury approves of it, and the President has said fine, Sullivan can give it the works tomorrow, see, and then the President is going to get hold of LaFollette and Jimmie Byrnes tomorrow and the idea is to spring the LaFollette Bill on the floor and give it the Administration backing.

Gaston: Every once in awhile the sun breaks through.

H.M.Jr: Well, the only thing the President hasn't had that he wants is the D. C. Tax Bill. It is worth your (Sullivan's) intestinal fortitude. We will get you a new set of intestines, too.

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Sullivan: You might get a spare set while you are at it.

H.M.Jr: We will give him two pairs, one gold and one silver.

Bell: Use the silver one in the House and the gold in the Senate.

H.M.Jr: That is right, silver threads among the gold.

Sullivan: "On July 10th Congressional leaders meeting with Administration officers agreed to proceed to the enactment of an Excess Profits Tax Bill. Proceeding according to instructions received from the House Ways and Means Committee and the Conference Committee on the Revenue Act of 1940, Treasury experts prepared an excess profits tax bill which was completed on July 22nd. To this plan the Sub-committee on Internal Revenue Taxation added an alternative proposal of which the Treasury disapproved but which it was willing to accept because of the necessity of prompt action. During the Executive Sessions of the House Ways and Means Committee certain changes were made in the Sub-committee's proposal which reduced the advantages the prosperous, well-established corporations would have over the new and small corporations. These changes in the Treasury's opinion greatly improved the bill.

"During the deliberations before the Senate Finance Committee you have deemed it advisable to remove these changes. Since the newspaper accounts of these changes have indicated this action of the Committee has met with Treasury approval, I feel obliged to state the position of the Department.

"By removing the 4.1% on normal tax net income imposed on corporations for the privilege of filing under the average earnings method and by changing the rate schedule so that corporations filing under the average earnings method pay at the same rate as those

filing under the invested capital method, there is restored to the bill the same objectional discrimination in favor of the prosperous, well-established corporation using average earnings of which the House Ways and Means Committee and the Treasury Department so emphatically disapproved. By increasing the normal corporation income tax on all corporations by a flat 3.1% to make up the loss of revenue caused by excusing corporations using average earnings rates from the 4.1% privilege tax proposed in the House Ways and Means bill, the bill is made even more objectionable for it abandons very largely the excess profits tax philisophy of taxing with due regard to the corporate ability to pay.

"The bill as it leaves this Committee is estimated to yield gross revenue on 1940 income of $355,000,000. Of this amount $240,000,000 will be due to the increase in normal corporate income tax rates. There remains but $115,000,000 gross revenue which it is estimated will be paid on 1940 income as excess profits taxes.

"I sincerely hope that our cooperation in this matter will not be misinterpreted as acquiescence in the type of an excess profits tax bill that you are about to report which the Treasury Department in view of its years of experience in administering the tax laws feels compelled to condemn."

H.M.Jr: I think there are several things here. If you will go straight through, I don't know whether you have got "prosperous, well-established corporations." I am fearful thatthey can say, well, you are opposed to corporations being prosperous and well-established. I think just for the moment, you can leave the next sentence out.

White: Say, "Corporations making high profits."

H.M.Jr: Well, we are not opposed to that, either.

If we can just leave that out for the minute.

"By increasing the normal corporation income tax on all corporations by a flat 3.1% ..... the bill is made even more objectionable -" I would say the bill is something or other. It is objectionable or something or other.

White: Discriminates against the small corporations.

H.M.Jr: Well, I mean, "the bill abandons very largely the excess profits tax philosophy with due regard to corporate ability to pay."

White: That could be rephrased.

H.M.Jr: That could be rephrased. If you are not feeling well, why don't you let a couple of the boys here work on it for you tonight, fresh, and give you something in the morning and go on home?

Sullivan: All right.

H.M.Jr: See what I mean, John?

Sullivan: I see.

H.M.Jr: I mean you are are all pent up on this thing and I don't blame you. If I even made --

Sullivan: Oh, I didn't pull any punches.

H.M.Jr: I'm not asking you to pull punches. I think you can say this, that the bill abandons largely the excess profits tax philosophy of taxes with due regard to corporate ability to pay. You don't have to say anything more about that. That is cutting the throat, isn't it?

Sullivan: I should hope so.

H.M.Jr: And you don't have to say the thing is - and give the "Johnny Haneses" and the "Willkies" and the rest of them a chance to just grab this thing and say, "Oh oh, the Administration

doesn't believe in prosperous, well-established corporations." I mean, it is unnecessary. You have given it the stab when you say it abandons largely the excess profits philosophy.

Sullivan: Well, that can be easily changed in the second line.

H.M.Jr: I don't think you stress enough that the thing that we want is to give a break to new business, small business, or business that hasn't been making any money.

Gaston: Yes, let's grab that end of it instead of --

White: Discriminating against those --

Gaston: Instead of tackling the big fellows, and championing the little fellows.

H.M.Jr: But these three fellows can take this thing and give you something to look at in the morning, but this Administration is interested in the little fellow, the man who wants to start a new business or the fellow who has had tough sledding in the last four years, and this bill makes it impossible for these fellows to get a start, and we are interested in them and not against the other fellow. Catch?

White: Right.

H.M.Jr: And then the other thing - and I am just throwing it out because I want to get you home - I sincerely hope we will not - "I sincerely hope that our cooperation in this matter -" I don't think I would say that last thing at all. "I sincerely hope that our cooperation in this matter will not be misinterpreted -". If you say the other thing, you don't have to say that.

White: It shouldn't be apologetic.

H.M.Jr: I don't like the last paragraph at all.

Bell: You could say, "We have tried to cooperate."

H.M.Jr: No - I mean, I think you could say something like this, "Everybody, I am sure, in this room, will agree that everybody connected with the Treasury - that the Treasury has given you all possible technical and legal advice and support, et cetera, et cetera. We have worked day and night. But I am simply here to say that the product which is being reported out today is not one that we can give our approval to," something like that. What I am trying to get over, John, is this: I think by understatement, a very calm statement, that is all you have to do, that what you are going to say is a bombshell. Simply say, "We don't like this bill, and I feel that I have done everything possible in giving you the whole Treasury Staff to help you do this. Now that it is through, I want to stand here and simply say that the Treasury says this bill has not got its approval." That is all you have to say. The fireworks will come from them.

Sullivan: Yes, sir.

H.M.Jr: You just say, "I am sorry, gentlemen, we can't give it our approval."

Sullivan: And they say, "Well, what do you approve?" "Well, we proposed a plan and now there is another one which Senator LaFollette has introduced which we are for."

H.M.Jr: If he will have introduced it by that time. But do you agree with me?

Sullivan: Yes, I do.

H.M.Jr: Are we together?

Sullivan: Entirely so.

H.M.Jr: Could you fellows let him out a little bit and give him something he could look at and if he doesn't like it he doesn't need

to use it. I think you had better go home because you are going to have a tough day tomorrow.

Gaston: Is this for tomorrow morning at ten o'clock?

H.M.Jr: Yes. Would you do that for him?

Gaston: Yes, send it up tonight.

H.M.Jr: They will give you the kind of service I am accustomed to.

Sullivan: Thank you very much.

H.M.Jr: How is that?

Sullivan: Swell.

H.M.Jr: This is good news. If the President gets this, he has got everything.

Bell: When is he going to give out his statement, tomorrow afternoon?

H.M.Jr: On the tax bill? He isn't going to give out a statement. He is going to let LaFollette - the plan is, LaFollette is going to do it. They are not going to say a thing. Nobody knows the President - nobody knows where the President stands. Then LaFollette comes out on the floor and introduces this thing and suddenly Barkley and Jimmie Byrnes go to bat for the LaFollette Bill. That is the answer. Do you get it?

Bell: Yes.

H.M.Jr: I mean, here you will find Barkley and Jimmie Byrnes going to bat for LaFollette and they passed the thing in the Senate with a Democratic backing. That is, that is the way we were as of 5 minutes to one this morning.

Gaston: What is Jimmie going to be - will he be all right?

H.M.Jr: The President told me over the telephone that Jimmie Byrnes told him that he can pass the LaFollette Bill.

Sullivan: The President hasn't talked with Barkley, has he?

H.M.Jr: No.

Sullivan: Now, in the House the two men, Cooper and McCormick --

H.M.Jr: Well, that is another thing. You go on home and these boys will do a job for you and send it up to you.

Sullivan: Thanks very much.

H.M.Jr: You have been carrying the ball and I say you don't have to use it if you don't like it, but I will just give you that little bit of help.

Sullivan: Swell.

H.M.Jr: Are you fellows with me on the twist I gave you?

White: No question about it.

Gaston: No question about it.

H.M.Jr: Danny?

Bell: Yes.

H.M.Jr: Mrs. Klotz?

Klotz: Yes.

Sullivan: One thing you ought to know, these suggestions they have been making we thought were terrible. We have worked them over and then drafted this.

Bell: I don't see how John is going to quite get out of it when they ask him in the end what has he got to suggest now. He will say,

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"We suggested a good bill and you turned it down." "Well, where do we go from here?" He can't say anything about the LaFollette plan.

H.M.Jr: Well, he can stick to the original Treasury bill.

Sullivan: Either that or a bill like the 1918 Act, which is the LaFollette Bill.

White: Or a bill that embodies the spirit of the original act, and in this way he can pave the way for the LaFollette Bill.

H.M.Jr: You're not afraid of that question, are you?

Sullivan: Not in the slightest.

H.M.Jr: Good night. Thank you.

Everybody else, good night.

September 10, 1940

Sent to President in his bedroom 830 am 9-11-40

My dear Mr. President:

I am inclosing herewith the two tax bills before the Senate. I am also enclosing a summary, which Mr. Sullivan has given me, of Senator La Follette's bill.

May I remind you that on the telephone you said you would get in touch with both Senator La Follette and Senator Byrnes.

Yours sincerely,

The President,

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1st Draft

MEMORANDUM

September 10, 1940.

TO: Secretary Morgenthau

FROM: Mr. Sullivan

The amendment to be proposed by Senator LaFollette eliminates both the present invested capital and average earnings standards in the present bill. It substitutes therefor a plan of allowing every corporation a specific exemption of $5,000 plus 8% of the invested capital of the taxable year.

Example:

Corporation has 1940 invested capital			$1,000,000
1940 Profit		$100,000	
Specific Exemption	$ 5,000		
8% Invested Capital	80,000		
Total Exemption	$85,000	85,000	
Profits subject to excess profits		$ 15,000	
Excess Profits Tax (25%)		$ 3,750	

Rate Schedule:

25%	Taxable profit not exceeding 7% of invested capital.
40%	Taxable profits above 7% and below 15% of invested capital.
50%	Taxable profits above 15% of invested capital.

"Invested capital" is the sum of the equity capital (money and property paid in plus paid-in-surplus and contributions to capital) plus one-half the borrowed money.

The completed LaFollette amendment will not exceed 25 pages and will be substituted for the present Title I which consumes 80 pages.

The estimate on the LaFollette amendment for 1940 is $475,000,000.

The estimate on the present bill is $350,000,000 of which $225,000,000 is an increase in the corporate tax rate which will be paid by every corporation regardless of size.

JLS:kb

9/11 185

Mr. Sullivan wanted to substitute this page for page 2 submitted to the Secretary 9/10, but the letter to the President went at 8:30 this morning before the corrected second page was received.

"Invested capital" is the sum of the equity capital (money and property paid in plus paid-in-surplus and contributions to capital) plus one-half the borrowed money.

The completed LaFollette amendment will not exceed 25 pages and will be substituted for the present Title I which consumes 80 pages.

The estimate on the LaFollette amendment for 1940 is $475,000,000.

The estimate on the present bill is $355,000,000 of which $240,000,000 is an increase in the corporate tax rate which will be paid by every corporation regardless of size.

[COMMITTEE PRINT]

SEPTEMBER 6, 1940

76TH CONGRESS
3D SESSION

H. R. 10413

IN THE SENATE OF THE UNITED STATES

SEPTEMBER , 1940

Referred to the Committee on and ordered to be printed

AMENDMENTS

Intended to be proposed by Mr. LA FOLLETTE to the bill (H. R. 10413) to provide revenue, and for other purposes, viz: On page 1, beginning with line 5, strike out through line 19, page 80, and insert in lieu thereof the following:

TITLE I—EXCESS PROFITS TAX

SEC. 101. EXCESS PROFITS TAX OF 1940.

The Internal Revenue Code is amended by inserting after section 706 the following new subchapter which may be cited as the "Excess Profits Tax Act of 1940":

"SUBCHAPTER E—EXCESS PROFITS TAX

"SEC. 710. IMPOSITION OF TAX.

"(a) IMPOSITION.—There shall be levied, collected, and paid, for each taxable year beginning after December 31,

1 depreciation provided in section 23 ( ) of Chapter 1;
2 and
3 "(5) INCOME FROM RETIREMENT OR DISCHARGE
4 OF BONDS, AND SO FORTH.—There shall be excluded, in
5 the case of any corporation, income derived from the
6 retirement or discharge of any of its bonds, debentures,
7 notes, or certificates or other evidences of indebtedness,
8 which have been outstanding for more than eighteen
9 months.
10 "(b) TAXABLE YEAR LESS THAN TWELVE MONTHS.—
11 If the taxable year is a period of less than twelve months
12 the excess profits net income shall be placed on an annual
13 basis by multiplying the amount thereof by the number of
14 days in the twelve months ending with the close of the
15 taxable year and dividing by the number of days in the
16 taxable year. The tax shall be such part of the tax computed
17 on such annual basis as the number of days in the taxable
18 year is of the number of days in the twelve months ending
19 with the close of the taxable year.
20 **"SEC. 712. EXCESS PROFITS CREDIT.**
21 "The excess profits credit shall consist of an amount
22 equal to 8 per centum of the invested capital for the taxable
23 year determined under section 713.
24 **"SEC. 713. DEFINITION OF INVESTED CAPITAL.**
25 "For the purposes of this subchapter the invested capital

1 for any taxable year shall be the average invested capital
2 for such year, determined under section 714, reduced by an
3 amount computed under section 718 (relating to inadmis-
4 sible assets). (For computation of invested capital in case
5 of foreign corporations, see section 721.)

6 **"SEC. 714. AVERAGE INVESTED CAPITAL.**

7 "The average invested capital for any taxable year for
8 which the tax under this subchapter is being computed
9 shall be the aggregate of the daily invested capital for each
10 day of such taxable year, divided by the number of days
11 in such taxable year.

12 **"SEC. 715. DAILY INVESTED CAPITAL.**

13 "The daily invested capital for any day of the taxable
14 year shall be the sum of the equity invested capital for such
15 day plus the borrowed invested capital for such day
16 determined under section 717.

17 **"SEC. 716. EQUITY INVESTED CAPITAL.**

18 "(a) DEFINITION.—The equity invested capital for any
19 day of any taxable year shall be determined as of the begin-
20 ning of such day and shall be the sum of the following
21 amounts, reduced as provided in subsection (b)—

22 "(1) MONEY PAID IN.—Money previously paid in
23 for stock, or as paid-in surplus, or as a contribution
24 to capital;

25 "(2) PROPERTY PAID IN.—Property (other than

1 money) previously paid in (regardless of the time paid
2 in) for stock, or as paid-in surplus, or as a contribution
3 to capital. Such property shall be included in an amount
4 equal to its basis (unadjusted) for determining loss upon
5 sale or exchange. If the property was disposed of be-
6 fore such taxable year, such basis shall be determined
7 in the same manner as if the property were still held
8 at the beginning of such taxable year. If such unad-
9 justed basis is a substituted basis it shall be adjusted,
10 with respect to the period before the property was paid
11 in, in the manner provided in section 113 (b) (2);
12 "(3) TAXABLE STOCK DIVIDENDS.—Distributions
13 in stock—
14 "(A) Made prior to such taxable year to the
15 extent to which they are considered distributions of
16 earnings and profits; and
17 "(B) Previously made during such taxable
18 year to the extent to which they are considered
19 distributions of earnings and profits other than earn-
20 ings and profits of such taxable year; and
21 "(4) EARNINGS AND PROFITS AT BEGINNING OF
22 YEAR.—The accumulated earnings and profits as of the
23 beginning of such taxable year.
24 "(b) REDUCTION IN EQUITY INVESTED CAPITAL.—
25 The amount by which the equity invested capital for any

1 day shall be reduced as provided in subsection (a) shall be
2 the sum of the following amounts—
3 "(1) DISTRIBUTIONS IN PREVIOUS YEARS.—Dis-
4 tributions made prior to such taxable year which were
5 not out of accumulated earnings and profits; and
6 "(2) DISTRIBUTIONS DURING THE YEAR.—Dis-
7 tributions previously made during such taxable year
8 which are not out of the earnings and profits of such
9 taxable year.
10 "(c) RULES FOR APPLICATION OF SUBSECTIONS (a)
11 AND (b).—For the purposes of subsections (a) and (b)—
12 "(1) DISTRIBUTIONS TO SHAREHOLDERS.—The
13 term 'distribution' means a distribution by a corporation
14 to its shareholders, and the term 'distribution in stock'
15 means a distribution by a corporation in its stock or
16 rights to acquire its stock. To the extent that a distri-
17 bution in stock is not considered a distribution of earn-
18 ings and profits it shall not be considered a distribution.
19 A distribution in stock shall not be regarded as money
20 or property paid in for stock, or as paid-in surplus, or as
21 a contribution to capital.
22 "(2) DISTRIBUTIONS IN FIRST SIXTY DAYS OF
23 TAXABLE YEAR.—In the application of such subsections
24 to any taxable year beginning after December 31, 1940,
25 so much of the distributions (taken in the order of time)

1 made during the first sixty days thereof as does not
2 exceed the accumulated earnings and profits as of the
3 beginning thereof (computed without regard to this
4 paragraph) shall be considered to have been made on
5 the last day of the preceding taxable year.

6 "(3) COMPUTATION OF EARNINGS AND PROFITS
7 OF TAXABLE YEAR.—For the purposes of subsections
8 (a) (3) (B) and (b) (2) in determining whether
9 a distribution is out of the earnings and profits of any
10 taxable year, such earnings and profits shall be com-
11 puted as of the close of such taxable year without
12 diminution by reason of any distribution made during
13 such taxable year or by reason of the tax under this
14 subchapter for such year and the determination shall
15 be made without regard to the amount of earnings and
16 profits at the time the distribution was made.

17 "(4) EARNINGS AND PROFITS OF TRANSFEROR
18 CORPORATION.—For the purposes of subsection (a) (4)
19 the accumulated earnings and profits of the corpora-
20 tion shall be determined without the inclusion of any
21 of the earnings and profits of a transferor corporation
22 which would otherwise be included by reason of prop-
23 erty of such transferor having been paid in for shares of,
24 or as a contribution to the capital of, or as paid-in
25 surplus of, the transferee corporation.

1 "(d) COMPUTATION OF ACCUMULATED EARNINGS
2 AND PROFITS.—For the purposes of this section, accumulated
3 earnings and profits shall be determined without regard to
4 whether the accumulation was before, on, or after March 1,
5 1913. Nothing in section 401 of the Second Revenue Act
6 of 1940 shall affect the extent to which accumulated earnings
7 and profits are increased by reason of increase in value of
8 property accrued before March 1, 1913.

9 "(e) For determination of equity invested capital in
10 special cases, see section 720.

11 "(f) For special rules affecting computation of equity
12 invested capital in connection with certain exchanges and
13 liquidations, see section 719.

14 **"SEC. 717. BORROWED INVESTED CAPITAL.**

15 "(a) BORROWED CAPITAL.—The borrowed capital for
16 any day of any taxable year shall be determined as of the
17 beginning of such day and shall be the amount of the out-
18 standing indebtedness (not including interest, and not in-
19 cluding indebtedness described in section 719 (c) relating
20 to certain exchanges) of the taxpayer which is evidenced
21 by a bond, note, bill of exchange, debenture, certificate of
22 indebtedness, mortgage, or deed of trust.

23 "(b) BORROWED INVESTED CAPITAL.—The borrowed
24 invested capital for any day of any taxable year shall be

1 determined as of the beginning of such day and shall be the
2 sum of the following amounts:
3 "(1) An amount equal to that portion of the bor-
4 rowed capital for such day which does not exceed the
5 excess of $100,000 over the equity invested capital for
6 such day;
7 "(2) (A) If the equity invested capital for such
8 day is less than $100,000, an amount equal to 66⅔ per
9 centum of that portion of the remainder of the borrowed
10 capital for such day which does not exceed $900,000; or
11 "(B) If the equity invested capital for such day is
12 $100,000 or more and is less than $1,000,000, an
13 amount equal to 66⅔ per centum of that portion of the
14 borrowed capital for such day which does not exceed
15 the excess of $1,000,000 over the equity invested capital
16 for such day; and
17 "(3) An amount equal to 33⅓ per centum of that
18 portion of the borrowed capital for such day as exceeds
19 the sum of—
20 "(A) The amount ascertained under paragraph
21 (1), plus
22 "(B) 150 per centum of the amount ascer-
23 tained under paragraph (2).

1 "SEC. 718. ADMISSIBLE AND INADMISSIBLE ASSETS.

2 "(a) DEFINITIONS.—For the purposes of this sub-
3 chapter—

4 "(1) The term 'inadmissible assets' means—

5 "(A) Stock in corporations except stock in a
6 foreign personal-holding company; and

7 "(B) Obligations described in section 22 (b)
8 (4) (A), (B), or (C) any part of the interest
9 from which is excludible from gross income or allow-
10 able as a credit against net income.

11 "(2) The term 'admissible assets' means all assets
12 other than inadmissible assets.

13 "(b) RATIO OF INADMISSIBLES TO TOTAL ASSETS.—
14 The amount by which the average invested capital for any
15 taxable year shall be reduced as provided in section 713 shall
16 be an amount which is the same percentage of such average
17 invested capital as the percentage which the total of the
18 inadmissible assets is of the total of admissible and inadmis-
19 sible assets. For such purpose, the amount attributable to
20 each asset held at any time during such taxable year shall
21 be determined by ascertaining the adjusted basis thereof (or,
22 in the case of money, the amount thereof) for each day of
23 such taxable year so held and adding such daily amounts.

1 The determination of such daily amounts shall be made under
2 regulations prescribed by the Commissioner with the ap-
3 proval of the Secretary. In the case of the taxable year for
4 which the tax under this subchapter is being determined, the
5 adjusted basis shall be the adjusted basis for determining loss
6 upon sale or exchange as determined under section 113.

7 "(c) COMPUTATION IF SHORT-TERM CAPITAL
8 GAIN.—If during the taxable year there has been a short-
9 term capital gain with respect to an inadmissible asset, then
10 so much of the amount attributable to such inadmissible asset
11 under subsection (b) as bears the same ratio thereto as such
12 gain bears to the sum of such gain plus the dividends and
13 interest on such asset for such year, shall, for the purpose
14 of determining the ratio of inadmissible assets to the total
15 of admissible and inadmissible assets, be added to the total
16 of admissible assets and subtracted from the total of inadmis-
17 sible assets.

18 **"SEC. 719. DETERMINATION OF PROPERTY PAID IN FOR**
19 **STOCK AND OF BORROWED CAPITAL IN CON-**
20 **NECTION WITH CERTAIN EXCHANGES.**

21 "(a) DEFINITIONS.—As used in this section—

22 "(1) EXCHANGE.—The term 'exchange' means an
23 exchange, described in section 112 (b) (4) or (5)
24 or in so much of section 112 (c), (d), or (e) as refers
25 to section 112 (b) (4) or (5), by one corporation of

its property wholly or in part for stock or securities of another corporation, or a transfer of property by one corporation to another corporation, the basis of which in the hands of such other corporation is or was determined under section 113 (a) (8) (B), or would have been so determined had such section been in effect.

"(2) TRANSFEROR UPON AN EXCHANGE.—The term 'transferor upon an exchange' means a corporation which upon an exchange transfers property to another corporation in exchange, wholly or in part, for stock or securities of such other corporation, or transfers property to another corporation, the basis of which in the hands of such other corporation is or was determined under section 113 (a) (8) (B), or would have been so determined had such section been in effect.

"(3) TRANSFEREE UPON AN EXCHANGE.—The term 'transferee upon an exchange' means a corporation which upon an exchange acquires property from another corporation in exchange, wholly or in part, for its stock or securities, or which acquires property from another corporation, the basis of which in its hands is or was determined under section 113 (a) (8) (B), or would have been so determined had such section been in effect.

"(b) PROPERTY PAID IN FOR STOCK.—In the appli-

1 cation of section 716 (a) to a transferee upon an exchange,
2 in determining the amount paid in for stock of the transferee,
3 or as paid-in surplus or as a contribution to capital of the
4 transferee, in connection with such exchange, only an amount
5 shall be deemed to have been so paid in equal to the excess
6 of the basis in the hands of the transferee of the property
7 of the transferor received by the transferee upon the exchange
8 over the sum of—

9 "(1) Any liability of the transferor assumed upon
10 such exchange and any liability subject to which the
11 property was received upon such exchange, plus

12 "(2) The aggregate of the amount of money and the
13 fair market value of any other property transferred to
14 the transferor not permitted to be received by such trans-
15 feror without the recognition of gain.

16 "(c) BORROWED CAPITAL.—In the application of sec-
17 tion 717 (a) to a transferee upon an exchange, the term
18 'borrowed capital' shall not include indebtedness originally
19 evidenced by securities issued by the transferee upon such
20 exchange as consideration for the property of the transferor
21 received by the transferee upon such exchange if (1) such
22 securities were property permitted to be received by the
23 person to whom such securities were issued without the rec-
24 ognition of gain and (2) the indebtedness originally evi-
25 denced by such securities did not arise out of indebtedness of

1 the transferor (other than indebtedness which in the trans-
2 feror's hands was subject to the limitations of this subsection)
3 assumed by the transferee in connection with such exchange.

4 **"SEC. 720. EQUITY INVESTED CAPITAL IN SPECIAL CASES.**

5 "Where the Commissioner determines that the equity
6 invested capital as of the beginning of the taxpayer's first
7 taxable year under this subchapter cannot be determined
8 in accordance with section 716, the equity invested capital
9 as of the beginning of such year shall be an amount equal
10 to the sum of (a) the money plus (b) the aggregate of
11 the adjusted basis of the assets of the taxpayer held by the
12 taxpayer at such time, such sum being reduced by the in-
13 debtedness outstanding at such time. The amount of the
14 money, assets, and indebtedness at such time shall be deter-
15 mined in accordance with rules and regulations prescribed
16 by the Commissioner with the approval of the Secretary.
17 In such case, the equity invested capital for each day after
18 the beginning of the taxpayer's first taxable year under this
19 subchapter shall be determined, in accordance with rules
20 and regulations prescribed by the Commissioner with the
21 approval of the Secretary, using as the basic figure the
22 equity invested capital as so determined.

23 **"SEC. 721. FOREIGN CORPORATIONS—INVESTED CAPITAL.**

24 "Notwithstanding section 713, in the case of a foreign
25 corporation engaged in trade or business within the United

1 States or having an office or place of business therein, the
2 invested capital for any taxable year shall be determined in
3 accordance with rules and regulations prescribed by the
4 Commissioner with the approval of the Secretary, under
5 which—

6 "(a) GENERAL RULE.—The daily invested capital for
7 any day of the taxable year shall be the aggregate of the
8 adjusted basis of each United States asset held by the tax-
9 payer on the beginning of such day. In the application of
10 section 718 in reduction of the average invested capital (de-
11 termined on the basis of such daily invested capital), the
12 terms 'admissible assets' and 'inadmissible assets' shall in-
13 clude only United States assets; or

14 "(b) EXCEPTION.—If the Commissioner determines
15 that the United States assets of the taxpayer cannot satis-
16 factorily be segregated from its other assets, the invested
17 capital for the taxable year shall be an amount which is the
18 same percentage of the aggregate of the adjusted basis of
19 of all assets held by the taxpayer as of the end of the last
20 day of the taxable year which the net income for the taxable
21 year from sources within the United States is of the total
22 net income of the taxpayer for such year.

23 "(c) DEFINITION OF UNITED STATES ASSET.—As
24 used in this subsection, the term 'United States asset' means
25 an asset held by the taxpayer in the United States, deter-

1 mined in accordance with rules and regulations prescribed
2 by the Commissioner with the approval of the Secretary.
3 "SEC. 722. PERSONAL SERVICE CORPORATIONS.
4 "(a) DEFINITION.—As used in this subchapter, the
5 term 'personal service corporation' means a corporation
6 whose income is to be ascribed primarily to the activities of
7 shareholders who are regularly engaged in the active con-
8 duct of the affairs of the corporation and are the owners at
9 all times during the taxable year of at least 80 per centum
10 in value of all the stock of the corporation, and in which
11 capital is not a material income-producing factor; but does
12 not include any foreign corporation, nor any corporation 50
13 per centum or more of whose gross income consists of gains,
14 profits, or income derived from trading as a principal. For
15 the purposes of this subsection, an individual shall be con-
16 sidered as owning, at any time, the stock owned at such time
17 by his spouse or minor child.
18 "(b) ELECTION AS TO TAXABILITY.—If a personal
19 service corporation signifies, in its return under Chapter 1
20 for any taxable year, its desire not to be subject to the tax
21 imposed under this subchapter for such taxable year, it shall
22 be exempt from such tax for such year, and the provisions
23 of Supplement S of Chapter 1 shall apply to the share-
24 holders in such corporation who were such shareholders on
25 the last day of such taxable year of the corporation.

1 "SEC. 723. CORPORATIONS COMPLETING CONTRACTS UN-
2 DER MERCHANT MARINE ACT, 1936.

3 "(a) If the United States Maritime Commission certi-
4 fies to the Commissioner that the taxpayer has completed
5 within the taxable year any contracts or subcontracts which
6 are subject to the provisions of section 505 (b) of the
7 Merchant Marine Act of 1936, as amended, then the tax
8 imposed by this subchapter for such taxable year shall be,
9 in lieu of a tax computed under section 710, a tax computed
10 under subsection (b) of this section, if, and only if, the
11 tax computed under subsection (b) is less than the tax
12 computed under section 710.

13 "(b) The tax computed under this subsection shall be
14 the excess of—

15 "(1) A tentative tax computed under section 710
16 with the excess profits net income increased by the
17 amount of any payments made, or to be made, to the
18 United States Maritime Commission with respect to
19 such contracts or subcontracts; over

20 "(2) The amount of such payments.

21 "SEC. 724. EXEMPT CORPORATIONS.

22 "The following corporations shall be exempt from the
23 tax imposed by this subchapter:

24 "(a) Corporations exempt under section 101 from the
25 tax imposed by Chapter 1.

1 "(b) Foreign personal-holding companies, as defined
2 in section 331.
3 "(c) Mutual investment companies, as defined in sec-
4 tion 361.
5 "(d) Investment companies which under the Invest-
6 ment Company Act of 1940 are registered as diversified
7 companies at all times during the taxable year. In the case
8 of taxable years beginning in 1940 a company shall be con-
9 sidered as so registered at all times during such taxable year
10 before the date of such registration, if such registration is
11 made before December 1, 1940.
12 "(e) Personal-holding companies, as defined in section
13 501.
14 "(f) Foreign corporations not engaged in trade or
15 business within the United States and not having an office
16 or place of business therein.
17 "(g) Domestic corporations satisfying the following
18 conditions:
19 "(1) If 95 per centum or more of the gross income
20 of such domestic corporation for the three-year period
21 immediately preceding the close of the taxable year (or
22 for such part of such period during which the corporation
23 was in existence) was derived from sources other than
24 sources within the United States; and
25 "(2) If 50 per centum or more of its gross income

1 for such period or such part thereof was derived from
2 the active conduct of a trade or business.
3 "(h) Any corporation subject to the provisions of Title
4 IV of the Civil Aeronautics Act of 1938, in the gross income
5 of which for any taxable year beginning after December 31,
6 1939, there is includible compensation received from the
7 United States for the transportation of mail by aircraft if,
8 after excluding from its gross income such compensation, its
9 adjusted excess-profits net income for such year is zero or
10 less.

11 **"SEC. 725. MEANING OF TERMS USED.**

12 "The terms used in this subchapter shall have the same
13 meaning as when used in Chapter 1.

14 **"SEC. 726. LAWS APPLICABLE.**

15 "(a) GENERAL RULE.—All provisions of law (includ-
16 ing penalties) applicable in respect of the taxes imposed by
17 Chapter 1, shall, insofar as not inconsistent with this sub-
18 chapter, be applicable in respect of the tax imposed by this
19 subchapter.
20 "(b) RETURNS.—Notwithstanding subsection (a), no
21 return under section 52 (a) shall be required to be filed
22 by any taxpayer under this subchapter for any taxable year
23 for which its excess profits net income, computed with the
24 adjustments provided in Section 711 (a) and placed on an
25 annual basis as provided in section 711 (b), is not greater
26 than $5,000.

1 "(c) FOREIGN TAXES PAID.—In the application of sec-
2 tion 131 for the purposes of this subchapter the tax paid
3 or accrued to any country shall be deemed to be the amount
4 of such tax reduced by the amount of the credit allowed
5 with respect to such tax against the tax imposed by Chap-
6 ter 1.

7 "(d) LIMITATIONS ON AMOUNT OF FOREIGN TAX
8 CREDIT.—The amount of the credit taken under this section
9 shall be subject to each of the following limitations:

10 "(1) The amount of the credit in respect of the tax
11 paid or accrued to any country shall not exceed the same
12 proportion of the tax against which such credit is taken,
13 which the taxpayer's excess profits net income from
14 sources within such country bears to its entire excess
15 profits net income for the same taxable years; and

16 "(2) The total amount of the credit shall not exceed
17 the same proportion of the tax against which such credit
18 is taken, which the taxpayer's excess profits net income
19 from sources without the United States bears to its entire
20 excess profits net income for the same taxable year."

21 On page 97, line 25, strike out "723" and insert in lieu
22 thereof "722".

23 On page 101, line 13, strike out "723" and insert in lieu
24 thereof "722".

[COMMITTEE PRINT]

SEPTEMBER 6, 1940

76TH CONGRESS
3D SESSION

H. R. 10413

AMENDMENTS

Intended to be proposed by Mr. LA FOLLETTE to the bill (H .R. 10413) to provide revenue, and for other purposes.

SEPTEMBER , 1940

Referred to the Committee on _____ and ordered to be printed

76TH CONGRESS
3D SESSION

H. R. 10413

IN THE SENATE OF THE UNITED STATES

AUGUST 30 (legislative day, AUGUST 5), 1940

Read twice and referred to the Committee on Finance

AN ACT

To provide revenue, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That this Act may be cited as the "Second Revenue Act
4 of 1940".

5 TITLE I—EXCESS PROFITS TAX

6 SEC. 101. EXCESS PROFITS TAX OF 1940.

7 The Internal Revenue Code is amended by inserting
8 after section 706 the following new subchapter which may
9 be cited as the "Excess Profits Tax Act of 1940":

1 "SUBCHAPTER E—EXCESS PROFITS TAX

2 "Part I

3 "SEC. 710. IMPOSITION OF TAX.

4 "(a) IMPOSITION.—There shall be levied, collected,
5 and paid, for each taxable year beginning after December
6 31, 1939, on the excess profits net income, as defined in
7 section 711, of every corporation (except a corporation
8 exempt under section 725)—

9 "(1) INCOME CREDIT.—If the taxpayer's excess
10 profits credit is computed under section 713, a tax equal
11 to 4 1/10 per centum of the normal-tax net income, as
12 defined in section 13 (a) (2), plus:

13 "Upon adjusted excess profits net incomes of
14 less than $20,000, 25 per centum of the adjusted
15 excess profits net income.

16 "$5,000 upon adjusted excess profits net in-
17 comes of $20,000; and upon adjusted excess profits
18 net incomes in excess of $20,000, and not in excess
19 of $50,000, 30 per centum in addition of such excess.

20 "$14,000 upon adjusted excess profits net in-
21 comes of $50,000; and upon adjusted excess profits
22 net incomes in excess of $50,000, and not in excess
23 of $100,000, 35 per centum in addition of such
24 excess.

25 "$31,500 upon adjusted excess profits net in-

comes of $100,000; and upon adjusted excess profits net incomes in excess of $100,000, and not in excess of $250,000, 40 per centum in addition of such excess.

"$91,500 upon adjusted excess profits net incomes of $250,000; and upon adjusted excess profits net incomes in excess of $250,000, and not in excess of $500,000, 45 per centum in addition of such excess.

"$204,000 upon adjusted excess profits net incomes of $500,000; and upon adjusted excess profits net incomes in excess of $500,000, 50 per centum in addition of such excess.

"(2) INCOME AND INVESTED CAPITAL CREDIT.—If the taxpayer's excess profits credit is computed under section 714, a tax as follows:

"Upon adjusted excess profits net incomes of less than $20,000, 20 per centum of the adjusted excess profits net income.

"$4,000 upon adjusted excess profits net incomes of $20,000; and upon adjusted excess profits net incomes in excess of $20,000, and not in excess of $50,000, 25 per centum in addition of such excess.

"$11,500 upon adjusted excess profits net in-

comes of $50,000; and upon adjusted excess profits net incomes in excess of $50,000, and not in excess of $100,000, 30 per centum in addition of such excess.

"$26,500 upon adjusted excess profits net incomes of $100,000; and upon adjusted excess profits net incomes in excess of $100,000, and not in excess of $250,000, 35 per centum in addition of such excess.

"$79,000 upon adjusted excess profits net incomes of $250,000; and upon adjusted excess profits net incomes in excess of $250,000, and not in excess of $500,000, 40 per centum in addition of such excess.

"$179,000 upon adjusted excess profits net incomes of $500,000; and upon adjusted excess profits net incomes in excess of $500,000, 45 per centum in addition of such excess.

"(3) APPLICATION OF RATES IN CASE OF CERTAIN EXCHANGES.—If the taxpayer's preferential rate amount for the taxable year computed under section 759 (relating to certain exchanges) is less than $500,000, then in the application of paragraphs (1) and (2) of this subsection to such taxpayer, in lieu of each amount, other than the percentages, specified in such paragraphs, there shall be substituted an amount which bears the same ratio to the

1 amount so specified as the preferential rate amount so
2 computed bears to $500,000.
3 "(b) DEFINITION OF ADJUSTED EXCESS PROFITS
4 NET INCOME.—As used in this section, the term 'adjusted
5 excess profits net income' in the case of any taxable year
6 means the excess profits net income minus the sum of:
7 "(1) SPECIFIC EXEMPTION.—A specific exemp-
8 tion of $5,000; and
9 "(2) EXCESS PROFITS CREDIT.—The amount of
10 the excess profits credit allowed under section 712.
11 "SEC. 711. EXCESS PROFITS NET INCOME.
12 "(a) TAXABLE YEARS BEGINNING AFTER DECEMBER
13 31, 1939.—The excess profits net income for any taxable
14 year beginning after December 31, 1939, shall be the nor-
15 mal-tax net income, as defined in section 13 (a) (2), for
16 such year except that the following adjustments shall be
17 made:
18 "(1) EXCESS PROFITS CREDIT COMPUTED UNDER
19 INCOME CREDIT.—If the excess profits credit is computed
20 under section 713, the adjustments shall be as follows:
21 "(A) Income Taxes.—The deduction for taxes
22 shall be increased by an amount equal to the tax
23 under Chapter 1 for such taxable year;
24 "(B) Long-term Capital Gains and Losses.—
25 There shall be excluded long-term capital gains and

1 losses. For the purposes of this subparagraph, prop-
2 erty otherwise constituting a capital asset shall not
3 be deemed to be excluded from the definition of
4 such term because it was of a character which is
5 subject to the allowance for depreciation provided
6 in section 23 (l) of Chapter 1; and
7 "(C) Income From Retirement or Discharge of
8 Bonds, and So Forth.—There shall be excluded, in
9 the case of any corporation, income derived from the
10 retirement or discharge of any of its bonds, deben-
11 tures, notes, or certificates or other evidences of
12 indebtedness, which have been outstanding for more
13 than eighteen months.
14 "(2) EXCESS PROFITS CREDIT COMPUTED UNDER
15 INCOME AND INVESTED CAPITAL CREDIT.—If the excess
16 profits credit is computed under section 714, the adjust-
17 ments shall be as follows:
18 "(A) Dividends Received.—The credit for
19 dividends received shall apply, without limitation,
20 to all dividends on stock of all corporations, except
21 dividends (actual or constructive) on stock of
22 foreign personal-holding companies;
23 "(B) Interest.—The deduction for interest
24 shall be reduced by an amount which is the same
25 percentage of so much of such interest as repre-

1 sents interest on the indebtedness included in the
2 daily amounts of borrowed capital (determined
3 under section 719 (a)) as the percentage which the
4 sum of the daily amounts of borrowed invested
5 capital (determined under section 719 (b)) is of
6 the sum of the daily amounts of the borrowed
7 capital;

8 "(C) Income Taxes.—The deduction for taxes
9 shall be increased by an amount equal to the tax
10 under Chapter 1 for such taxable year;

11 "(D) Long-term Capital Gains and Losses.—
12 There shall be excluded gains or losses to the same
13 extent as provided in paragraph (1) (B); and

14 "(E) Income From Retirement or Discharge
15 of Bonds, and So Forth.—There shall be excluded,
16 in the case of any corporation, income derived from
17 the retirement or discharge of any of its bonds,
18 debentures, notes, or certificates or other evidences
19 of indebtedness, which have been outstanding for
20 more than eighteen months.

21 "(3) TAXABLE YEAR LESS THAN TWELVE
22 MONTHS.—If the taxable year is a period of less than
23 twelve months the excess profits net income shall be
24 placed on an annual basis by multiplying the amount
25 thereof by the number of days in the twelve months end-

ing with the close of the taxable year and dividing by the number of days in the taxable year. The tax shall be such part of the tax computed on such annual basis as the number of days in the taxable year is of the number of days in the twelve months ending with the close of the taxable year.

"(b) TAXABLE YEARS IN BASE PERIOD.—

"(1) GENERAL RULE.—The excess profits net income for any taxable year subject to the Revenue Act of 1936 shall be the normal-tax net income, as defined in section 13 (a) of such Act; and for any other taxable year beginning after December 31, 1937, and before January 1, 1940, shall be the special-class net income, as defined in section 14 (a) of the applicable revenue law. In either case the adjustments provided in paragraph (2) of this subsection shall be made. (For additional adjustments in case of certain reorganizations, see section 742 (e).)

"(2) ADJUSTMENTS.—

"(A) Excess Profits Credit Computed Under Income Credit.—If the excess profits credit is computed under section 713, then the adjustments shall be as follows:

"(i) Income taxes.—The deduction for taxes shall be increased by an amount equal to

1 the tax for such taxable year under Title I
2 or Chapter 1, as the case may be, of the revenue
3 law applicable to such year;
4 "(ii) Long-term capital gains and losses.—
5 There shall be excluded long-term capital gains
6 and losses;
7 "(iii) Income from retirement or discharge
8 of bonds, and so forth.—There shall be ex-
9 cluded, in the case of any corporation, income
10 derived from the retirement or discharge of any
11 of its bonds, debentures, notes, or certificates
12 or other evidences of indebtedness, which have
13 been outstanding for more than eighteen
14 months;
15 "(iv) Casualty losses.—Deductions for
16 losses arising from fires, storms, shipwreck, or
17 other casualty, or from theft, not compensated
18 for by insurance or otherwise, shall not be al-
19 lowed; and
20 "(v) Repayment to vendees of processing
21 tax.—The deduction under section 23 (a),
22 for any taxable year, for expenses shall be
23 decreased by an amount equal to the amount
24 deductible on account of any repayment or
25 credit by the corporation to its vendee of any

1 amount attributable to any tax under the Agri-
2 cultural Adjustment Act of 1933, as amended.
3 For the purposes of this clause, the adjustment
4 for the first taxable year in the base period shall
5 be the excess of the amount so deductible for
6 such year over the amount includible in gross
7 income for such year by reason of the tax under
8 such Act which was not paid, and the ad-
9 justment for any succeeding taxable year in the
10 base period shall be the excess of the amount so
11 deductible for such year and all previous years
12 in the base period over the amounts so includible
13 in gross income for such year and all previous
14 taxable years in the base period.
15 "(B) Excess Profits Credit Computed Under
16 Income and Invested Capital Credit.—If the excess
17 profits credit is computed under section 714, then
18 the adjustments shall be as follows:
19 "(i) Dividends, interest, and taxes.—The
20 credit for dividends received and the deductions
21 for interest and taxes shall be adjusted in a
22 manner similar to that provided in subsection
23 (a) (2) (A), (B), and (C);
24 "(ii) Long-term capital gains and losses.—
25 There shall be excluded long-term capital gains
26 and losses;

1 "(iii) Income from retirement or discharge
2 of bonds, and so forth.—There shall be ex-
3 cluded, in the case of any corporation, income
4 derived from the retirement or discharge of
5 any of its bonds, debentures, notes, or certifi-
6 cates or other evidences of indebtedness, which
7 have been outstanding for more than eighteen
8 months;
9 "(iv) Casualty losses.—Deductions for
10 losses arising from fires, storms, shipwreck, or
11 other casualty, or from theft, not compensated
12 for by insurance or otherwise, shall not be
13 allowed; and
14 "(v) Repayment of processing tax to
15 vendees.—The deduction under section 23 (a),
16 for any taxable year, for expenses shall be de-
17 creased by an amount equal to the amount de-
18 ductible on account of any repayment or credit
19 by the corporation to its vendee of any amount
20 attributable to any tax under the Agricultural
21 Adjustment Act of 1933, as amended. For the
22 purposes of this clause, the adjustment for the
23 first taxable year in the base period shall be the
24 excess of the amount so deductible for such year
25 over the amount includible in gross income for

1 such year by reason of the tax under such Act
2 which was not paid, and the adjustment for any
3 succeeding taxable year in the base period shall
4 be the excess of the amount so deductible for
5 such year and all previous years in the base
6 period over the amounts so includible in gross
7 income for such year and all previous taxable
8 years in the base period.

9 "(3) CAPITAL GAINS AND LOSSES.—For the pur-
10 poses of this subsection the normal tax net income and
11 the special-class net income referred to in paragraph
12 (1) shall be computed as if section 117 were part of
13 the revenue law applicable to the taxable year the
14 excess profits net income of which is being computed,
15 with the exceptions (A) that property otherwise con-
16 stituting a capital asset shall not, if held for more
17 than eighteen months, be deemed to be excluded
18 from the definition of such term because it was
19 of a character which is subject to the allowance
20 for depreciation provided for in section 23 (l), and
21 (B) that the net short-term capital loss carry-over pro-
22 vided in subsection (e) of such section shall be
23 applicable to net short-term capital losses for taxable
24 years beginning after December 31, 1934. The ex-
25 ception provided in clause (B) shall not apply for

1 the purposes of computing the tax under this subchapter
2 for any taxable year beginning before January 1, 1941.
3 "SEC. 712. EXCESS PROFITS CREDIT—ALLOWANCE.
4 "(a) DOMESTIC CORPORATIONS.—In the case of a
5 domestic corporation, the first taxable year of which under
6 this subchapter begins on any date in 1940, which was in
7 existence during the entire forty-eight months prior to such
8 date, the excess profits credit for any taxable year shall,
9 at the election of the taxpayer made in its return for such
10 taxable year, be an amount computed under section 713
11 or section 714. (For election in case of certain reorgani-
12 zations of corporations not qualified under the preceding
13 sentence, see section 741.) In the case of all other domestic
14 corporations the excess profits credit for any taxable year
15 shall be an amount computed under section 714.
16 "(b) FOREIGN CORPORATIONS.—In the case of a for-
17 eign corporation engaged in trade or business within the
18 United States or having an office or place of business
19 therein, the first taxable year of which under this sub-
20 chapter begins on any date in 1940, which was in existence
21 on the day forty-eight months prior to such date and which
22 at any time during each of the taxable years in such forty-
23 eight months was engaged in trade or business within the
24 United States or had an office or place of business therein, the
25 excess profits credit for any taxable year shall be an amount

1 computed under section 713. In the case of all other such
2 foreign corporations the excess profits credit for any taxable
3 year shall be an amount computed under section 714.

4 "SEC. 713. EXCESS PROFITS CREDIT—BASED ON INCOME.

5 "(a) AMOUNT OF EXCESS PROFITS CREDIT.—The
6 excess profits credit for any taxable year, computed under
7 this section, shall be—

8 "(1) DOMESTIC CORPORATIONS.—In the case of
9 a domestic corporation, the average base period net
10 income, as defined in subsection (b), increased by 8
11 per centum of the net capital addition, as defined in
12 subsection (c), or decreased by 6 per centum of the
13 net capital reduction, as defined in subsection (c).

14 "(2) FOREIGN CORPORATIONS.—In the case of a
15 foreign corporation, the average base period net income.

16 "(b) AVERAGE BASE PERIOD NET INCOME.—For the
17 purposes of this section the average base period net income
18 of the taxpayer shall be determined as follows:

19 "(1) By computing the aggregate of the excess
20 profits net income for each of the taxable years of the
21 taxpayer beginning after December 31, 1935, and be-
22 fore January 1, 1940, reduced, in the case of each
23 such taxable year in which the deductions plus the
24 credit for dividends received exceeded the gross income,
25 by the amount attributable to such excess under
26 paragraph (4).

1 "(2) By dividing the amount ascertained under
2 paragraph (1) by the total number of months in all
3 such taxable years; and
4 "(3) By multiplying the amount ascertained under
5 paragraph (2) by twelve.
6 "(4) For the purposes of paragraph (1)—
7 "(A) In determining whether, for any taxable
8 year, the deductions plus the credit for dividends
9 received exceeded the gross income, and in deter-
10 mining the amount of such excess, the adjustments
11 provided in section 711 (b) (2) (A) shall be
12 made; and
13 "(B) The amount attributable to any taxable
14 year in which there is such an excess shall be the
15 amount of such excess, except that such amount
16 shall be zero if there is only one such year, or, if
17 more than one, shall be zero for the year in which
18 such excess is the greatest.
19 "(5) In no case shall the average base period
20 net income be less than zero.
21 "(6) For computation of average base period net
22 income in case of certain reorganizations, see section 742.
23 "(c) ADJUSTMENTS IN EXCESS PROFITS CREDIT ON
24 ACCOUNT OF CAPITAL CHANGES.—For the purposes of
25 this section—

1 "(1) The net capital addition for the taxable year
2 shall be the excess, divided by the number of days in
3 the taxable year, of the aggregate of the daily capital
4 addition for each day of the taxable year over the ag-
5 gregate of the daily capital reduction for each day of
6 the taxable year.

7 "(2) The net capital reduction for the taxable
8 year shall be the excess, divided by the number of days
9 in the taxable year, of the aggregate of the daily capital
10 reduction for each day of the taxable year over the
11 aggregate of the daily capital addition for each day of
12 the taxable year.

13 "(3) The daily capital addition for any day of the
14 taxable year shall be the aggregate of the amounts of
15 money and property paid in for stock, or as paid-in
16 surplus, or as a contribution to capital, after the be-
17 ginning of the taxpayer's first taxable year under this
18 subchapter and prior to such day. In determining the
19 amount of any property paid in, such property shall be
20 included in an amount determined in the manner pro-
21 vided in section 718 (a) (2). A distribution by the
22 taxpayer to its shareholders in its stock or rights to
23 acquire its stock shall not be regarded as money or
24 property paid in for stock, or as paid-in surplus, or as
25 a contribution to capital. The amount ascertained under

1 this paragraph shall be reduced by the excess, if any,
2 of the excluded capital for such day over the excluded
3 capital for the first day of the taxpayer's first taxable
4 year under this subchapter. For the purposes of this
5 paragraph the excluded capital for any day shall be an
6 amount equal to the sum of the following:

7 "(A) The aggregate of the adjusted basis
8 (for determining loss upon sale or exchange) as
9 of the beginning of such day, of obligations held by
10 the taxpayer at the beginning of such day, which
11 are described in section 22 (b) (4) (A), (B),
12 or (C) any part of the interest from which is
13 excludible from gross income or allowable as a
14 credit against net income; and

15 "(B) 85 per centum of the aggregate of the
16 adjusted basis (for determining loss upon sale or
17 exchange) as of the beginning of such day, of stock
18 held by the taxpayer at the beginning of such day,
19 with respect to dividends upon which the credit
20 provided in section 26 (b) is allowable.

21 The daily capital addition shall in no case be less than
22 zero. (For daily capital additions and reductions in
23 case of certain reorganizations, see section 743.)

24 "(4) The daily capital reduction for any day of the
25 taxable year shall be the aggregate of the amounts of

1 distributions to shareholders, not out of earnings and
2 profits, after the beginning of the taxpayer's first taxable
3 year under this subchapter and prior to such day.

4 "SEC. 714. EXCESS PROFITS CREDIT—BASED ON INCOME
5 AND INVESTED CAPITAL.

6 "(a) AMOUNT OF EXCESS PROFITS CREDIT.—The ex-
7 cess profits credit, for any taxable year, computed under this
8 section, shall be the amount computed under subsection (b),
9 (c), (d), or (e), as the case may be. If the taxpayer's
10 preferential rate amount computed under Supplement B of
11 Part II (relating to certain exchanges) is less than $500,000,
12 then in the application of subsection (b), (c), (d), or (e),
13 as the case may be, of this section to such taxpayer, the pref-
14 erential rate amount so computed shall be substituted for
15 $500,000.

16 "(b) INVESTED CAPITAL AND LOWEST INVESTED
17 CAPITAL NOT MORE THAN $500,000.—If neither the in-
18 vested capital (determined under section 715) for such tax-
19 able year nor the lowest invested capital (determined under
20 subsection (f) of this section) is more than $500,000,
21 then—

22 "(1) INVESTED CAPITAL NOT MORE THAN LOWEST
23 INVESTED CAPITAL.—If such invested capital is not
24 more than the lowest invested capital, the base period
25 percentage (as defined in subsection (f)), or 7 per

1 centum, whichever is the greater, of the amount of such
2 invested capital; or
3 "(2) INVESTED CAPITAL MORE THAN LOWEST IN-
4 VESTED CAPITAL.—If such invested capital is more than
5 the lowest invested capital, an amount equal to the sum
6 of the following: (A) The base period percentage, or
7 7 per centum, whichever is the greater, of an amount
8 equal to the lowest invested capital, and (B) 10 per
9 centum of the amount by which such invested capital
10 exceeds the lowest invested capital.
11 "(c) INVESTED CAPITAL NOT MORE THAN $500,000
12 AND LOWEST INVESTED CAPITAL MORE THAN $500,000.—
13 If the invested capital for the taxable year is not more than
14 $500,000, and the lowest invested capital is more than
15 $500,000, the base period percentage, or 7 per centum,
16 whichever is the greater, of such invested capital.
17 "(d) INVESTED CAPITAL MORE THAN $500,000 AND
18 LOWEST INVESTED CAPITAL NOT MORE THAN $500,000.—
19 If the invested capital for the taxable year is more than
20 $500,000, and the lowest invested capital is not more than
21 $500,000, an amount equal to the sum of the following:
22 "(1) The base period percentage, or 7 per centum,
23 whichever is the greater, of an amount equal to the
24 lowest invested capital; and

1 "(2) 10 per centum of the amount by which
2 $500,000 exceeds the lowest invested capital; and
3 "(3) 8 per centum of the amount by which such
4 invested capital exceeds $500,000.
5 "(e) INVESTED CAPITAL AND LOWEST INVESTED
6 CAPITAL MORE THAN $500,000.—If the invested capital
7 for the taxable year and the lowest invested capital are each
8 more than $500,000, then—
9 "(1) INVESTED CAPITAL NOT MORE THAN LOWEST
10 INVESTED CAPITAL.—If the invested capital for the tax-
11 able year is not more than the lowest invested capital,
12 an amount equal to the sum of the following: (A)
13 The base period percentage, or 7 per centum, whichever
14 is the greater, of $500,000, and (B) the base period
15 percentage of the amount by which such invested capital
16 exceeds $500,000;
17 "(2) INVESTED CAPITAL MORE THAN LOWEST
18 INVESTED CAPITAL.—If the invested capital for the
19 taxable year is more than the lowest invested capital,
20 an amount equal to the sum of the following: (A) The
21 base period percentage, or 7 per centum, whichever is
22 the greater, of $500,000, (B) the base period per-
23 centage of the amount by which the lowest invested
24 capital exceeds $500,000, and (C) 8 per centum of the

1 amount by which such invested capital exceeds the
2 lowest invested capital.
3 "(f) DEFINITIONS.—For the purposes of the excess
4 profits credit computed under this section—
5 "(1) (A) Except as provided in section 754 (re-
6 lating to certain exchanges) the term 'base period' in
7 the case of any taxpayer (except a taxpayer described
8 in subparagraph (B) of this paragraph) means the
9 taxable years beginning after December 31, 1935, and
10 before January 1, 1940.
11 "(B) In the case of a taxpayer the first taxable
12 year of which under this subchapter begins on any date
13 in 1940, which was in existence during only part of the
14 forty-eight months prior to such date, the base period
15 shall, except as provided in section 754 (relating to cer-
16 tain exchanges) be such forty-eight months.
17 "(2) (A) The term 'base period net income'
18 means the aggregate of the excess profits net income for
19 each of the taxable years in the base period, reduced,
20 in the case of each year in such period in which the
21 deductions plus the credit for dividends received ex-
22 ceeded the gross income, by the amount attributable to
23 such excess under this subparagraph. For the purposes
24 of this subparagraph in determining whether, for any
25 taxable year, the deductions plus the credit for dividends

received exceeded the gross income, and in determining the amount of such excess, the adjustments provided in section 711 (b) (2) (B) shall be made; and the amount attributable to any taxable year in which there is such an excess shall be the amount of such excess, except that such amount shall be zero if there is only one such year, or, if more than one, shall be zero for the year in which such excess is the greatest.

"(B) In the case of a taxpayer the base period of which is determined under paragraph (1) (B) of this subsection, the excess profits net income for any of the taxable years the invested capital of which is computed under paragraph (3) shall be the sum, multiplied by the number of days in such taxable year and divided by the number of days in the twelve months ending with the close of the taxable year, of (i) 10 per centum of so much of the amount determined under paragraph (5) (B) of this subsection as does not exceed $500,000 and (ii) 8 per centum of the remainder of such amount.

"(3) In the case of a taxpayer the base period of which is determined under paragraph (1) (B) of this subsection—

"(A) The invested capital for each of the taxable years of twelve months (beginning with the beginning of its base period) during the whole of

which it was not in existence shall be the amount determined under paragraph (5) (B) of this subsection; and

"(B) The invested capital for the taxable year consisting of the remainder of that part of its base period during which it was not in existence shall be the amount determined under paragraph (5) (B) of this subsection multiplied by the number of days in such remainder, and divided by the number of days in the twelve months preceding the first day of its existence.

"(4) (A) Except as provided in subparagraphs (B) and (C) of this paragraph, the term 'base period percentage' means the percentage which the base period net income is of the aggregate of the invested capital for each of the taxable years in the base period, but such percentage shall not be less than 5 nor more than 10.

"(B) Except as provided in subparagraph (C) of this paragraph the term 'base period percentage' as applied to a successor (as defined in section 750) means the percentage which the successor base period net income (as determined under section 755) is of the successor base period invested capital (as determined

1 under section 756) but such percentage shall not be
2 less than 5 nor more than 10.
3 "(C) In the case of a transferee upon an exchange
4 (as defined in section 750) the base period percentage
5 for the taxable year of the exchange and for succeeding
6 taxable years shall be determined under section 758.
7 "(5) Except as provided in section 757 (relating
8 to certain exchanges), in the case of a taxpayer which
9 was in existence before the beginning of its first taxable
10 year under this subchapter, its lowest invested capital
11 shall be whichever of the following amounts is the
12 smaller:
13 "(A) The smallest invested capital for any
14 preceding taxable year beginning after December
15 31, 1939; or
16 "(B) An amount equal to the invested capital
17 as of the beginning of the first day of the taxpayer's
18 first taxable year beginning after December 31,
19 1939, reduced by the same percentage of reduction
20 as is applicable under section 720 in reduction of
21 the average invested capital of the preceding tax-
22 able year.
23 "(6) Except as provided in section 757 (relating
24 to certain exchanges), in the case of a taxpayer which

1 was not in existence before the beginning of its first
2 taxable year under this subchapter, its lowest invested
3 capital shall be zero.

4 **"SEC. 715. DEFINITION OF INVESTED CAPITAL.**

5 "For the purposes of this subchapter the invested capital
6 for any taxable year (including the taxable years in the base
7 period) shall be the average invested capital for such year,
8 determined under section 716, reduced by an amount com-
9 puted under section 720 (relating to inadmissible assets).
10 (For computation of invested capital in case of foreign cor-
11 porations, see section 722.)

12 **"SEC. 716. AVERAGE INVESTED CAPITAL.**

13 "(a) TAXABLE YEARS IN THE TAXABLE PERIOD.—
14 The average invested capital for any taxable year for which
15 the tax under this subchapter is being computed shall be
16 the aggregate of the daily invested capital for each day of
17 such taxable year, divided by the number of days in such
18 taxable year.

19 "(b) TAXABLE YEARS IN THE BASE PERIOD.—The
20 average invested capital for any taxable year in the base
21 period shall be the aggregate of the daily invested capital for
22 each day of such taxable year, divided by the number of
23 days in the twelve months ending with the close of the
24 taxable year.

1 "SEC. 717. DAILY INVESTED CAPITAL.

2 "The daily invested capital for any day of the taxable
3 year shall be the sum of the equity invested capital for such
4 day plus the borrowed invested capital for such day deter-
5 mined under section 719.

6 "SEC. 718. EQUITY INVESTED CAPITAL.

7 "(a) DEFINITION.—The equity invested capital for
8 any day of any taxable year shall be determined as of the
9 beginning of such day and shall be the sum of the following
10 amounts, reduced as provided in subsection (b)—

11 "(1) MONEY PAID IN.—Money previously paid in
12 for stock, or as paid-in surplus, or as a contribution to
13 capital;

14 "(2) PROPERTY PAID IN.—Property (other than
15 money) previously paid in (regardless of the time paid
16 in) for stock, or as paid-in surplus, or as a contribution
17 to capital. Such property shall be included in an
18 amount equal to its basis (unadjusted) for determining
19 loss upon sale or exchange. If the property was dis-
20 posed of before such taxable year, such basis shall be
21 determined in the same manner as if the property were
22 still held at the beginning of such taxable year. If
23 such unadjusted basis is a substituted basis it shall be
24 adjusted, with respect to the period before the prop-

erty was paid in, in the manner provided in section 113 (b) (2);

"(3) TAXABLE STOCK DIVIDENDS.—Distributions in stock—

"(A) Made prior to such taxable year to the extent to which they are considered distributions of earnings and profits; and

"(B) Previously made during such taxable year to the extent to which they are considered distributions of earnings and profits other than earnings and profits of such taxable year; and

"(4) EARNINGS AND PROFITS AT BEGINNING OF YEAR.—The accumulated earnings and profits as of the beginning of such taxable year.

"(b) REDUCTION IN EQUITY INVESTED CAPITAL.—The amount by which the equity invested capital for any day shall be reduced as provided in subsection (a) shall be the sum of the following amounts—

"(1) DISTRIBUTIONS IN PREVIOUS YEARS.—Distributions made prior to such taxable year which were not out of accumulated earnings and profits; and

"(2) DISTRIBUTIONS DURING THE YEAR.—Distributions previously made during such taxable year

1 which are not out of the earnings and profits of such
2 taxable year.
3 "(c) RULES FOR APPLICATION OF SUBSECTIONS (a)
4 and (b).—For the purposes of subsections (a) and (b)—
5 "(1) DISTRIBUTIONS TO SHAREHOLDERS.—The
6 term 'distribution' means a distribution by a corporation
7 to its shareholders, and the term 'distribution in stock'
8 means a distribution by a corporation in its stock or
9 rights to acquire its stock. To the extent that a
10 distribution in stock is not considered a distribution of
11 earnings and profits it shall not be considered a dis-
12 tribution. A distribution in stock shall not be regarded
13 as money or property paid in for stock, or as paid-in
14 surplus, or as a contribution to capital.
15 "(2) DISTRIBUTIONS IN FIRST SIXTY DAYS OF
16 TAXABLE YEAR.—In the application of such subsection
17 to any taxable year beginning after December 31, 1940,
18 so much of the distributions (taken in the order of
19 time) made during the first sixty days thereof as does
20 not exceed the accumulated earnings and profits as of
21 the beginning thereof (computed without regard to this
22 paragraph) shall be considered to have been made on
23 the last day of the preceding taxable year.
24 "(3) COMPUTATION OF EARNINGS AND PROFITS
25 OF TAXABLE YEAR.—For the purposes of subsections

1 (a) (3) (B) and (b) (2) in determining whether a
2 distribution is out of the earnings and profits of any tax-
3 able year, such earnings and profits shall be computed as
4 of the close of such taxable year without diminution by
5 reason of any distribution made during such taxable
6 year or by reason of the tax under this subchapter for
7 such year and the determination shall be made without
8 regard to the amount of earnings and profits at the time
9 the distribution was made.

10 "(4) EARNINGS AND PROFITS OF TRANSFEROR
11 CORPORATION.—For the purposes of subsection (a) (4)
12 the accumulated earnings and profits of the corporation
13 shall be determined without the inclusion of any of the
14 earnings and profits of a transferor corporation which
15 would otherwise be included by reason of property of
16 such transferor having been paid in for shares of, or as
17 a contribution to the capital of, or as paid-in surplus of,
18 the transferee corporation.

19 "(d) COMPUTATION OF ACCUMULATED EARNINGS
20 AND PROFITS.—For the purposes of this section, accumu-
21 lated earnings and profits shall be determined without regard
22 to whether the accumulation was before, on, or after March
23 1, 1913. Nothing in section 401 of the Second Revenue
24 Act of 1940 shall affect the extent to which accumulated

1 earnings and profits are increased by reason of increase
2 in value of property accrued before March 1, 1913.
3 "(e) For determination of equity invested capital in
4 special cases, see section 721.
5 "(f) For special rules affecting computation of equity
6 invested capital in connection with certain exchanges and
7 liquidations, see sections 751 and 752.
8 "SEC. 719. BORROWED INVESTED CAPITAL.
9 "(a) BORROWED CAPITAL.—The borrowed capital for
10 any day of any taxable year shall be determined as of the
11 beginning of such day and shall be the amount of the out-
12 standing indebtedness (not including interest, and not includ-
13 ing indebtedness described in section 751 (b) relating to
14 certain exchanges) of the taxpayer which is evidenced by a
15 bond, note, bill of exchange, debenture, certificate of indebt-
16 edness, mortgage, or deed of trust.
17 "(b) BORROWED INVESTED CAPITAL.—The borrowed
18 invested capital for any day of any taxable year shall be
19 determined as of the beginning of such day and shall be
20 the sum of the following amounts:
21 "(1) An amount equal to that portion of the bor-
22 rowed capital for such day which does not exceed the
23 excess of $100,000 over the equity invested capital for
24 such day;
25 "(2) (A) If the equity invested capital for such

1 day is less than $100,000, an amount equal to 66⅔
2 per centum of that portion of the remainder of the
3 borrowed capital for such day which does not exceed
4 $900,000; or
5 "(B) If the equity invested capital for such day
6 is $100,000 or more and is less than $1,000,000, an
7 amount equal to 66⅔ percentum of that portion of the
8 borrowed capital for such day which does not exceed
9 the excess of $1,000,000 over the equity invested capital
10 for such day; and
11 "(3) An amount equal to 33⅓ per centum of that
12 portion of the borrowed capital for such day as exceeds
13 the sum of—
14 "(A) The amount ascertained under para-
15 graph (1), plus
16 "(B) 150 per centum of the amount ascer-
17 tained under paragraph (2).
18 "(c) If the taxpayer's second borrowed capital base
19 computed under Supplement B of Part II (relating to certain
20 exchanges) is less than $1,000,000, then in the application
21 of subsection (b) of this section to such taxpayer, such sec-
22 ond borrowed capital base shall be substituted for $1,000,000,
23 90 per centum of such second borrowed capital base shall be
24 substituted for $900,000, and the first borrowed capital base

1 computed under such Supplement shall be substituted for
2 $100,000.

3 "SEC. 720. ADMISSIBLE AND INADMISSIBLE ASSETS.

4 "(a) DEFINITIONS.—Except as provided in section 753
5 (relating to certain exchanges), for the purposes of this sub-
6 chapter—

7 "(1) The term 'inadmissible assets' means—

8 "(A) Stock in corporations except stock in a
9 foreign personal-holding company; and

10 "(B) Obligations described in section 22 (b)
11 (4) (A), (B), or (C) any part of the interest
12 from which is excludible from gross income or al-
13 lowable as a credit against net income.

14 "(2) The term 'admissible assets' means all assets
15 other than inadmissible assets.

16 "(b) RATIO OF INADMISSIBLES TO TOTAL ASSETS.—
17 The amount by which the average invested capital for any
18 taxable year shall be reduced as provided in section 715
19 shall be an amount which is the same percentage of such
20 average invested capital as the percentage which the total
21 of the inadmissible assets is of the total of admissible and
22 inadmissible assets. For such purposes, the amount attribut-
23 able to each asset held at any time during such taxable year
24 shall be determined by ascertaining the adjusted basis there-
25 of (or, in the case of money, the amount thereof) for each

1 day of such taxable year so held and adding such daily
2 amounts. The determination of such daily amounts shall be
3 made under regulations prescribed by the Commissioner
4 with the approval of the Secretary. In the case of the
5 taxable year for which the tax under this subchapter is
6 being determined, the adjusted basis shall be the adjusted
7 basis for determining loss upon sale or exchange as deter-
8 mined under section 113, and in the case of a taxable year
9 in the base period the adjusted basis shall be the adjusted
10 basis for determining loss upon sale or exchange as deter-
11 mined under the income tax law applicable to such taxable
12 year.

13 "(c) COMPUTATION IF SHORT-TERM CAPITAL
14 GAIN.—If during the taxable year there has been a short-
15 term capital gain with respect to an inadmissible asset, then
16 so much of the amount attributable to such inadmissible
17 asset under subsection (b) as bears the same ratio thereto
18 as such gain bears to the sum of such gain plus the dividends
19 and interest on such asset for such year, shall, for the purpose
20 of determining the ratio of inadmissible assets to the total
21 of admissible and inadmissible assets, be added to the total
22 of admissible assets and subtracted from the total of inad-
23 missible assets.

24 **"SEC. 721. EQUITY INVESTED CAPITAL IN SPECIAL CASES.**

25 "Where the Commissioner determines that the equity

1 invested capital as of the beginning of the taxpayer's first
2 taxable year under this subchapter cannot be determined in
3 accordance with section 718, the equity invested capital
4 as of the beginning of such year shall be an amount equal
5 to the sum of (a) the money plus (b) the aggregate of
6 the adjusted basis of the assets of the taxpayer held by the
7 taxpayer at such time, such sum being reduced by the in-
8 debtedness outstanding at such time. The amount of the
9 money, assets, and indebtedness at such time shall be deter-
10 mined in accordance with rules and regulations prescribed by
11 the Commissioner with the approval of the Secretary. In
12 such case, the equity invested capital for each day in the
13 taxpayer's base period and for each day after the beginning
14 of the taxpayer's first taxable year under this subchapter
15 shall be determined, in accordance with rules and regulations
16 prescribed by the Commissioner with the approval of the
17 Secretary, using as the basic figure the equity invested capi-
18 tal as so determined

19 **"SEC. 722. FOREIGN CORPORATIONS—INVESTED CAPITAL.**

20 "Notwithstanding section 715, in the case of a foreign
21 corporation engaged in trade or business within the United
22 States or having an office or place of business therein, the
23 invested capital for any taxable year shall be determined in
24 accordance with rules and regulations prescribed by the
25 Commissioner with the approval of the Secretary, under
26 which—

1 "(a) GENERAL RULE.—The daily invested capital for
2 any day of the taxable year shall be the aggregate of the
3 adjusted basis of each United States asset held by the tax-
4 payer on the beginning of such day. In the application
5 of section 720 in reduction of the average invested capital
6 (determined on the basis of such daily invested capital),
7 the terms 'admissible assets' and 'inadmissible assets' shall
8 include only United States assets; or

9 "(b) EXCEPTION.—If the Commissioner determines
10 that the United States assets of the taxpayer cannot satis-
11 factorily be segregated from its other assets, the invested
12 capital for the taxable year shall be an amount which is the
13 same percentage of the aggregate of the adjusted basis of
14 all assets held by the taxpayer as of the end of the last
15 day of the taxable year which the net income for the tax-
16 able year from sources within the United States is of the
17 total net income of the taxpayer for such year.

18 "(c) DEFINITION OF UNITED STATES ASSET.—As
19 used in this subsection, the term 'United States asset' means
20 an asset held by the taxpayer in the United States, deter-
21 mined in accordance with rules and regulations prescribed
22 by the Commissioner with the approval of the Secretary.

23 "SEC. 723. PERSONAL SERVICE CORPORATIONS.

24 "(a) DEFINITION.—As used in this subchapter, the
25 term 'personal service corporation' means a corporation

1 whose income is to be ascribed primarily to the activities
2 of shareholders who are regularly engaged in the active
3 conduct of the affairs of the corporation and are the owners
4 at all times during the taxable year of at least 80 per centum
5 in value of all the stock of the corporation, and in which
6 capital is not a material income-producing factor; but does
7 not include any foreign corporation, nor any corporation 50
8 per centum or more of whose gross income consists of gains,
9 profits, or income derived from trading as a principal. For
10 the purposes of this subsection, an individual shall be con-
11 sidered as owning, at any time, the stock owned at such time
12 by his spouse or minor child.

13 "(b) ELECTION AS TO TAXABILITY.—If a personal
14 service corporation signifies, in its return under Chapter 1 for
15 any taxable year, its desire not to be subject to the tax
16 imposed under this subchapter for such taxable year, it shall
17 be exempt from such tax for such year, and the provisions
18 of Supplement S of Chapter 1 shall apply to the shareholders
19 in such corporation who were such shareholders on the last
20 day of such taxable year of the corporation.

21 **"SEC. 724. CORPORATIONS COMPLETING CONTRACTS UN-**
22 **DER MERCHANT MARINE ACT, 1936.**

23 "(a) If the United States Maritime Commission cer-
24 tifies to the Commissioner that the taxpayer has completed
25 within the taxable year any contracts or subcontracts which
26 are subject to the provisions of section 505 (b) of the Mer-

1 chant Marine Act of 1936, as amended, then the tax im-
2 posed by this subchapter for such taxable year shall be, in
3 lieu of a tax computed under section 710, a tax computed
4 under subsection (b) of this section, if, and only if, the tax
5 computed under subsection (b) is less than the tax computed
6 under section 710.

7 "(b) The tax computed under this subsection shall be
8 the excess of—

9 "(1) A tentative tax computed under section 710
10 with the excess profits net income and the normal-tax
11 net income increased by the amount of any payments
12 made, or to be made, to the United States Maritime
13 Commission with respect to such contracts or subcon-
14 tracts; over

15 "(2) The amount of such payments.

16 **"SEC. 725. EXEMPT CORPORATIONS.**

17 "The following corporations shall be exempt from the
18 tax imposed by this subchapter:

19 "(a) Corporations exempt under section 101 from
20 the tax imposed by Chapter 1.

21 "(b) Foreign personal-holding companies, as defined
22 in section 331.

23 "(c) Mutual investment companies, as defined in sec-
24 tion 361.

25 "(d) Investment companies which under the Investment
26 Company Act of 1940 are registered as diversified companies

1 at all times during the taxable year. In the case of taxable
2 years beginning in 1940 a company shall be considered as so
3 registered at all times during such taxable year before the
4 date of such registration, if such registration is made before
5 December 1, 1940.

6 "(e) Personal-holding companies, as defined in sec-
7 tion 501.

8 "(f) Foreign corporations not engaged in trade or
9 business within the United States and not having an office
10 or place of business therein.

11 "(g) Domestic corporations satisfying the following
12 conditions:

13 "(1) If 95 per centum or more of the gross income
14 of such domestic corporation for the three-year period
15 immediately preceding the close of the taxable year
16 (or for such part of such period during which the
17 corporation was in existence) was derived from sources
18 other than sources within the United States; and

19 "(2) If 50 per centum or more of its gross income
20 for such period or such part thereof was derived from
21 the active conduct of a trade or business.

22 "(h) Any corporation subject to the provisions of Title
23 IV of the Civil Aeronautics Act of 1938, in the gross income
24 of which for any taxable year beginning after December 31,
25 1939, there is includible compensation received from the
26 United States for the transportation of mail by aircraft if,

1 after excluding from its gross income such compensation,
2 its adjusted excess profits net income for such year is zero
3 or less.

4 "SEC. 726. MEANING OF TERMS USED.

5 "The terms used in this subchapter shall have the same
6 meaning as when used in Chapter 1.

7 "SEC. 727. LAWS APPLICABLE.

8 "(a) GENERAL RULE.—All provisions of law (including
9 penalties) applicable in respect of the taxes imposed by
10 Chapter 1, shall, insofar as not inconsistent with this sub-
11 chapter, be applicable in respect of the tax imposed by this
12 subchapter.

13 "(b) RETURNS.—Notwithstanding subsection (a), no
14 return under section 52 (a) shall be required to be filed by
15 any taxpayer under this subchapter for any taxable year for
16 which its excess profits net income, computed with the ad-
17 justments provided in section 711 (a) (2) and placed on an
18 annual basis as provided in section 711 (a) (3), is not
19 greater than $5,000.

20 "(c) FOREIGN TAXES PAID.—In the application of
21 section 131 for the purposes of this subchapter the tax paid
22 or accrued to any country shall be deemed to be the amount
23 of such tax reduced by the amount of the credit allowed with
24 respect to such tax against the tax imposed by Chapter 1.

25 "(d) LIMITATIONS ON AMOUNT OF FOREIGN TAX

1 CREDIT.—The amount of the credit taken under this section
2 shall be subject to each of the following limitations:
3 "(1) The amount of the credit in respect of the tax
4 paid or accrued to any country shall not exceed the same
5 proportion of the tax against which such credit is taken,
6 which the taxpayer's excess profits net income from
7 sources within such country bears to its entire excess
8 profits net income for the same taxable year; and
9 "(2) The total amount of the credit shall not exceed
10 the same proportion of the tax against which such credit
11 is taken, which the taxpayer's excess profits net income
12 from sources without the United States bears to its entire
13 excess profits net income for the same taxable year.

14 **"Part II—Excess Profits Credit in Connection With**
15 **Certain Exchanges**

16 **"Supplement A—Credit Based on Income**

17 **"SEC. 740. DEFINITIONS.**

18 "For the purposes of this Supplement—
19 "(a) ACQUIRING CORPORATION.—The term 'acquiring
20 corporation' means—
21 "(1) A corporation which has acquired all the
22 assets of another corporation and the whole or a part of
23 the consideration for the transfer of such assets is the
24 transfer to such other corporation or its shareholders of
25 all the stock of all classes (except qualifying shares) of
26 the corporation which has acquired such assets;

1 "(2) A corporation which has acquired property
2 from another corporation in a transaction with respect to
3 which gain or loss was not recognized under section 112
4 (b) (6) of Chapter 1 or a corresponding provision of a
5 prior revenue law;
6 "(3) A corporation the result of a statutory merger
7 of two or more corporations; or
8 "(4) A corporation the result of a statutory con-
9 solidation of two or more corporations.
10 "(b) COMPONENT CORPORATION.—The term 'com-
11 ponent corporation' means—
12 "(1) In the case of a transaction described in sub-
13 section (a) (1), the corporation which transferred the
14 assets;
15 "(2) In the case of a transaction described in sub-
16 section (a) (2), the corporation the property of which
17 was acquired;
18 "(3) In the case of a statutory merger, all corpora-
19 tions merged, except the corporation resulting from the
20 merger; or
21 "(4) In the case of a statutory consolidation, all
22 corporations consolidated, except the corporation result-
23 ing from the consolidation.
24 "(c) QUALIFIED COMPONENT CORPORATION.—The
25 term 'qualified component corporation' means a component

1 corporation which was in existence on the date of the be-
2 ginning of the taxpayer's base period.
3 "(d) BASE PERIOD.—In the case of a taxpayer which
4 is an acquiring corporation the base period shall be:
5 "(1) If the tax is being computed for any taxable
6 year beginning in 1940, the forty-eight months pre-
7 ceding the beginning of such taxable year; or
8 "(2) If the tax is being computed for any taxable
9 year beginning after December 31, 1940, the forty-
10 eight months preceding what would have been its first
11 taxable year beginning in 1940 if it had had a taxable
12 year beginning in 1940 on the date on which the tax-
13 able year for which the tax is being computed began.
14 "(e) BASE PERIOD YEARS.—In the case of a taxpayer
15 which is an acquiring corporation its base period years shall
16 be the four successive twelve-month periods beginning on the
17 same date as the beginning of its base period.
18 "(f) EXISTENCE OF ACQUIRING CORPORATION.—For
19 the purposes of subsection (c) and section 741, if any com-
20 ponent corporation was in existence on the date of the begin-
21 ning of the taxpayer's base period (either actually or by
22 reason of this subsection), its acquiring corporation shall
23 be considered to have been in existence on such date.
24 "SEC. 741. ELECTION OF INCOME CREDIT.
25 "In addition to the corporations which under section
26 712 (a) may elect the excess profits credit computed under

1 section 713 or the excess profits credit computed under
2 section 714, a taxpayer which is an acquiring corporation
3 which was in existence on the date of the beginning of its
4 base period shall have such election.

5 **"SEC. 742. AVERAGE BASE PERIOD NET INCOME.**

6 "In the case of a taxpayer which is an acquiring cor-
7 poration which was in existence on the date of the begin-
8 ning of its base period, its average base period net income
9 (for the purpose of the credit computed under section 713)
10 shall be computed as follows, in lieu of the method provided
11 in section 713 (b):

12 "(a) By ascertaining with respect to each of its base
13 period years—

14 "(1) The amount of its excess profits net income
15 for each of its taxable years beginning after December
16 31, 1935, and ending with or within such base period
17 year; or, in the case of each such taxable year in which
18 the deductions plus the credit for dividends received
19 exceeded the gross income, the amount of such excess;

20 "(2) With respect to each qualified component
21 corporation, the amount of its excess profits net income
22 for each of its taxable years beginning after December
23 31, 1935, and ending with or within such base period
24 year of the taxpayer; or, in the case of each such taxable
25 year in which the deductions plus the credit for dividends

received exceeded the gross income, the amount of such excess;

"(3) (A) The aggregate of the amounts of excess profits net income ascertained under paragraphs (1) and (2); (B) the aggregate of the excesses ascertained under paragraphs (1) and (2); and (C) the difference between the aggregates found under clause (A) and clause (B). If the aggregate ascertained under clause (A) is greater than the aggregate found under clause (B), the difference shall for the purposes of subsection (b) be designated a 'plus amount', and if the aggregate ascertained under clause (B) is greater than the aggregate found under clause (A), the difference shall for the purposes of subsection (b) be designated a 'minus amount'.

"(b) By adding the plus amounts ascertained under subsection (a) (3) for each year of the base period; and by substracting from such sum, if for two or more years of the base period there was a minus amount, the sum of such minus amounts, excluding the greatest.

"(c) By dividing the amount ascertained under subsection (b) by four.

"(d) In no case shall the average base period net income be less than zero.

"(e) For the purposes of subsection (a) (1) and (2) of this section—

1 "(1) There shall be excluded, in the various com-
2 putations, any dividends paid by the taxpayer or any
3 qualified component corporation during any of the tax-
4 able years of the payor which are included in the com-
5 putation of the taxpayer's average base period net
6 income. If the payor corporation is a corporation
7 described in subsection (f) (1) or (2) of this section,
8 the dividends to be excluded under this paragraph shall
9 be only such as are paid after such payor corporation
10 first became an acquiring corporation; and
11 "(2) In determining whether, for any taxable year,
12 the deductions plus the credit for dividends received ex-
13 ceeded the gross income, and in determining the amount
14 of such excess, the adjustments provided in section 711
15 (b) (2) (A) shall be made.
16 "(f) (1) In the case of a taxpayer which is an acquir-
17 ing corporation and which was not actually in existence on
18 the date of the beginning of its base period, there shall be
19 excluded from the various computations under subsection
20 (a) (1) of this section the portion of its excess profits net
21 income, or of the excess over gross income therein referred
22 to, which is attributable to any period before it first became
23 an acquiring corporation.
24 "(2) In the case of a component corporation which
25 became a qualified component corporation only by reason
26 of section 740 (c), there shall be excluded from the various

1 computations under subsection (a) (2) of this section the
2 portion of its excess profits net income, or of the excess over
3 gross income therein referred to, which is attributable to any
4 period before it first became an acquiring corporation.

5 "(3) In the case of a qualified component corporation
6 which was actually in existence on the date of the begin-
7 ning of the taxpayer's base period, there shall be excluded
8 from the various computations under subsection (a) (2)
9 of this section the portion of its excess profits net income,
10 or of the excess over gross income therein referred to, which
11 is attributable to the period before such date.

12 "(4) If during the taxable year for which tax is com-
13 puted under this subchapter the taxpayer acquires assets in
14 a transaction which constitutes it an acquiring corporation,
15 the amount includible under subsection (a) (2), attributable
16 to such transaction, shall be limited to an amount which
17 bears the same ratio to the amount computed without regard
18 to this paragraph as the number of days in the taxable year
19 after such transaction bears to the total number of days
20 in such taxable year.

21 "SEC. 743. NET CAPITAL CHANGES.

22 "For the purposes of section 713 (c), upon the date
23 of the transaction which constitutes a corporation an acquir-
24 ing corporation, there shall be added to its daily capital
25 addition or reduction for such day, the net capital addition
26 or reduction, as the case may be, of each of the component

1 corporations involved in such transaction, but no other capital
2 addition or reduction shall be considered as having been made
3 by reason of such transaction. For the purposes of this
4 section—

5 "(a) In computing the net capital addition of each
6 such component corporation there shall be disregarded
7 property paid in to such corporation by the taxpayer or
8 by any of the component corporations involved in the trans-
9 action referred to in the first sentence; and

10 "(b) In computing the net capital reduction of each
11 such component corporation there shall be disregarded dis-
12 tributions made to the taxpayer or to any of such component
13 corporations.

14 **"SEC. 744. FOREIGN CORPORATIONS.**

15 "The term 'corporation' as used in this Supplement does
16 not include a foreign corporation.

17 **"Supplement B—Credit Based on Income and Invested Capital**

18 **"SEC. 750. DEFINITIONS.**

19 "As used in this Supplement—

20 "(a) EXCHANGE.—The term 'exchange' means an
21 exchange, described in section 112 (b) (4) or (5) or in
22 so much of section 112 (c), (d), or (e) as refers to sec-
23 tion 112 (b) (4) or (5), by one corporation of its property
24 wholly or in part for stock or securities of another corpora-
25 tion, or a transfer of property by one corporation to another
26 corporation, the basis of which in the hands of such other

1 corporation is or was determined under section 113 (a)
2 (8) (B), or would have been so determined had such
3 section been in effect.

4 "(b) TRANSFEROR UPON AN EXCHANGE.—The term
5 'transferor upon an exchange' means a corporation which
6 upon an exchange transfers property to another corporation
7 in exchange, wholly or in part, for stock or securities of such
8 other corporation, or transfers property to another cor-
9 poration, the basis of which in the hands of such other cor-
10 poration is or was determined under section 113 (a) (8)
11 (B), or would have been so determined had such section
12 been in effect.

13 "(c) TRANSFEREE UPON AN EXCHANGE.—The term
14 'transferee upon an exchange' means a corporation which
15 upon an exchange acquires property from another corpora-
16 tion in exchange, wholly or in part, for its stock or securities,
17 or which acquires property from another corporation, the
18 basis of which in its hands is or was determined under sec-
19 tion 113 (a) (8) (B), or would have been so determined
20 had such section been in effect.

21 "(d) CONTROL.—The term 'control' means the owner-
22 ship of stock possessing at least 90 per centum of the total
23 combined voting power of all classes of stock entitled to vote
24 and at least 90 per centum of the total value of shares of
25 all classes of stock of the corporation.

26 "(e) PREDECESSOR.—The term 'predecessor' means a

1 corporation which upon an exchange, or upon a liquidation
2 gain or loss upon which is not recognized by reason of sec-
3 tion 112 (b) (6) or the corresponding provision of a prior
4 revenue law, has transferred substantially all of its assets—
5 "(1) To a successor, or
6 "(2) To another predecessor.
7 "(f) SUCCESSOR.—The term 'successor' means a
8 corporation which was in existence prior to the beginning
9 of its first taxable year under this subchapter and which,
10 during its base period, was a transferee upon an exchange
11 of substantially all of the assets of one or more other
12 corporations, or which during its base period was a corpora-
13 tion receiving property upon the complete liquidation of one
14 or more other corporations gain or loss upon which was not
15 recognized by reason of section 112 (b) (6) or the cor-
16 responding provision of a prior revenue law.
17 "(g) PREFERENTIAL RATE AMOUNT.—The term 'pref-
18 erential rate amount' means $500,000 or the preferential rate
19 amount computed under section 759, whichever is the
20 smaller.
21 "(h) FIRST BORROWED CAPITAL BASE.—The term
22 'first borrowed capital base' means $100,000 or the first
23 borrowed capital base computed under section 760, which-
24 ever is the smaller.
25 "(i) SECOND BORROWED CAPITAL BASE.—The term

1 'second borrowed capital base' means $1,000,000 or the sec-
2 ond borrowed capital base computed under section 760,
3 whichever is the smaller.

4 **"SEC. 751. DETERMINATION OF PROPERTY PAID IN FOR**
5 **STOCK AND OF BORROWED CAPITAL IN CON-**
6 **NECTION WITH CERTAIN EXCHANGES.**

7 "(a) PROPERTY PAID IN FOR STOCK.—In the applica-
8 tion of section 718 (a) to a transferee upon an exchange
9 in determining the amount paid in for stock of the transferee,
10 or as paid-in surplus or as a contribution to capital of the
11 transferee, in connection with such exchange, only an amount
12 shall be deemed to have been so paid in equal to the excess
13 of the basis in the hands of the transferee of the property of
14 the transferor received by the transferee upon the exchange
15 (other than stock which was neither an admissible nor an
16 inadmissible asset in the hands of the transferor) over the
17 sum of—

18 "(1) Any liability of the transferor assumed upon
19 such exchange and any liability subject to which the
20 property was received upon such exchange, plus

21 "(2) The aggregate of the amount of money and the
22 fair market value of any other property transferred to the
23 transferor not permitted to be received by such transferor
24 without the recognition of gain.

25 "(b) BORROWED CAPITAL.—In the application of sec-
26 tion 719 (a) to a transferee upon an exchange, the term

'borrowed capital' shall not include indebtedness originally evidenced by securities issued by the transferee upon such exchange as consideration for the property of the transferor received by the transferee upon such exchange if (1) such securities were property permitted to be received by the person to whom such securities were issued without the recognition of gain and (2) the indebtedness originally evidenced by such securities did not arise out of indebtedness of the transferor (other than indebtedness which in the transferor's hands was subject to the limitations of this subsection) assumed by the transferee in connection with such exchange.

"SEC. 752. EQUITY INVESTED CAPITAL IN CONNECTION WITH CERTAIN EXCHANGES.

"(a) In the case of any transferor upon an exchange, its equity invested capital for each day subsequent to the day on which such exchange took place shall be reduced by an amount equal to the amount by which the equity invested capital of the transferee upon such exchange was increased by reason of the receipt of property from such transferor upon such exchange.

"(b) Equity invested capital for each day following the disposition of stock which is neither an admissible nor an inadmissible asset shall be increased by the sum of (1) the amount of money or the fair market value of property received therefor upon such disposition which is not permitted to be received without the recognition of gain, plus

1 (2) the amount of liabilities the assumption of which, or the
2 acquisition of property subject to which, is not considered
3 'other property or money' under section 112 (k), and
4 decreased by the amount of gain or increased by the amount
5 of loss recognized upon such disposition.

6 **"SEC. 753. EFFECT OF CERTAIN EXCHANGES UPON CER-**
7 **TAIN ADMISSIBLE AND INADMISSIBLE ASSETS.**

8 "For the purposes of section 720, stock of a transferee
9 upon an exchange received by a transferor upon such ex-
10 change shall be treated as neither an admissible nor an inad-
11 missible asset in the hands of such transferor and in the hands
12 of any transferee receiving such stock upon a subsequent
13 exchange or upon a complete liquidation described in section
14 112 (b) (6) from a transferor in whose hands such stock
15 was neither an admissible nor an inadmissible asset.

16 **"SEC. 754. BASE PERIOD OF SUCCESSORS.**

17 "For the purposes of this subchapter—

18 "(a) The term 'base period' in the case of any suc-
19 cessor (except a successor described in subsection (b) of
20 this section) means the period beginning with the first tax-
21 able year of such successor or any predecessor thereof begin-
22 ning after December 31, 1935, and ending with the day
23 preceding the beginning of such successor's first taxable year
24 under this subchapter.

25 "(b) In the case of a successor which was not, and none
26 of whose predecessors was, in existence at the beginning of

1 the forty-eight months prior to the beginning of the suc-
2 cessor's first taxable year under this subchapter, the base
3 period of such successor shall be such forty-eight months.
4 "(c) 'Base period year' in the case of any successor
5 means any one of the four successive twelve-month periods
6 beginning forty-eight months prior to the beginning of the
7 successor's first taxable year under this subchapter.
8 **"SEC. 755. SUCCESSOR BASE PERIOD NET INCOME.**
9 "(a) BASE PERIOD DETERMINED UNDER SECTION
10 754 (a).—The successor base period net income of a succes-
11 sor the base period of which is determined under section
12 754 (a) means the aggregate, reduced as provided in sub-
13 section (c), of—
14 "(1) The sum of the excess profits net income of
15 such successor for each of its taxable years in the base
16 period, and
17 "(2) The sum of the excess profits net income of
18 each predecessor thereof for each taxable year of such
19 predecessor beginning after December 31, 1935, and
20 before the exchange by reason of which it became a
21 predecessor with respect to such successor took place.
22 "(b) BASE PERIOD DETERMINED UNDER SECTION
23 754 (b).—The successor base period net income of a succes-
24 sor the base period of which is determined under section
25 754 (b) means the aggregate, reduced as provided in sub-
26 section (c), of—

1 "(1) The sum of the excess profits net income of
2 such successor for each of its taxable years in the base
3 period, and
4 "(2) The sum of the excess profits net income of
5 each predecessor thereof for each taxable year of such
6 predecessor beginning after December 31, 1935, and
7 before the exchange by reason of which it became a
8 predecessor with respect to such successor took place,
9 and
10 "(3) An amount equal to the sum of—
11 "(A) 10 per centum of so much of the amount
12 determined under section 714 (f) (5) (B) with
13 respect to such successor as does not exceed
14 $500,000, and
15 "(B) 8 per centum of the remainder of such
16 amount
17 multiplied by the number of periods of twelve months
18 (beginning with the beginning of the base period) dur-
19 ing the whole of which neither the successor nor any
20 predecessor thereof was in existence, and
21 "(4) An amount equal to the sum of—
22 "(A) 10 per centum of so much of the amount
23 determined under section 714 (f) (5) (B) with
24 respect to such successor as does not exceed
25 $500,000, and

1 "(B) 8 per centum of the remainder of such
2 amount
3 multiplied by the number of days in the remainder of
4 that part of the base period during which neither the
5 successor nor any predecessor thereof was in existence,
6 and divided by 365.
7 "(c) EFFECT OF DEFICITS ON SUCCESSOR BASE
8 PERIOD NET INCOME.—In the case of each taxable year of
9 the successor or any predecessor thereof during the base
10 period, in which the deductions plus the credit for dividends
11 received exceeded gross income, the sum of such excesses for
12 each such year shall, subject to the provisions of subsection
13 (d), be deducted from the amount determined under sub-
14 section (a) or subsection (b), as the case may be.
15 "(d) SPECIAL RULE IN CASE OF CONSOLIDATED
16 DEFICIT.—
17 "(1) In making the computations under subsec-
18 tions (a), (b), and (c), there shall be disregarded—
19 "(A) The excess profits net income of the suc-
20 cessor and of each predecessor thereof for any tax-
21 able year ending with or within the successor's base
22 period year in which occurred the largest consoli-
23 dated deficit, and
24 "(B) The excess of the deductions plus the
25 credit for dividends received over gross income for

1 any taxable year of the successor and for each tax-
2 able year of any predecessor thereof ending with or
3 within the successor's base period year in which oc-
4 curred the largest consolidated deficit.

5 "(2) For the purposes of this subsection 'consoli-
6 dated deficit' for any base period year means the excess
7 of—

8 "(A) The sum of the deductions plus the credit
9 for dividends received for each taxable year of the
10 successor and for each taxable year of any prede-
11 cessor thereof, ending with or within such base
12 period year, over

13 "(B) The sum of the gross income for each
14 taxable year of the successor and for each taxable
15 year of any predecessor thereof ending with or
16 within such base period year.

17 "(e) ADJUSTMENTS IN DETERMINING EXCESSES.—
18 In determining the amount of any excess under subsection
19 (c) or (d), the adjustments provided in section 711 (b)
20 shall be made.

21 "(f) CLOSING OF PREDECESSOR'S TAXABLE YEAR OF
22 EXCHANGE.—For the purposes of this section any predeces-
23 sor's taxable year in which the exchange by reason of which
24 it became a predecessor with respect to the successor took
25 place shall be deemed to have closed on the day of such
26 exchange.

1 "SEC. 756. SUCCESSOR BASE PERIOD INVESTED CAPITAL.

2 "(a) BASE PERIOD DETERMINED UNDER SECTION 754
3 (a).—The successor base period invested capital of a succes-
4 sor the base period of which is determined under section
5 754 (a) shall be the aggregate of—

6 "(1) Its invested capital for each of its taxable years
7 in the base period, and

8 "(2) The sum of the invested capital of each
9 predecessor thereof for each taxable year of such pred-
10 ecessor beginning after December 31, 1935, and before
11 the exchange by reason of which it became a predecessor
12 with respect to such successor took place. For the pur-
13 poses of this paragraph and section 715 such pred-
14 ecessor's taxable year in which such exchange took place
15 shall be deemed to have closed on the day of such
16 exchange.

17 "(b) BASE PERIOD DETERMINED UNDER SECTION 754
18 (b).—The successor base period invested capital of a succes-
19 sor the base period of which is determined under section 754
20 (b) shall be the aggregate of—

21 "(1) Its invested capital for each of its taxable years
22 in the base period, and

23 "(2) The sum of the invested capital of each pred-
24 ecessor thereof for each taxable year of such predecessor
25 beginning after December 31, 1935, and before the ex-

1 change by reason of which it became a predecessor with
2 respect to such successor took place. For the purposes
3 of this paragraph and section 715 such predecessor's
4 taxable year in which such exchange took place shall be
5 deemed to have closed on the day of such exchange, and
6 "(3) An amount equal to the amount determined
7 under section 714 (f) (5) (B) with respect to such
8 successor multiplied by the number of periods of twelve
9 months (beginning with the beginning of the base
10 period) during the whole of which neither the successor
11 nor any predecessor thereof was in existence, and
12 "(4) An amount equal to the amount determined
13 under section 714 (f) (5) (B) with respect to such
14 successor multiplied by the number of days in the re-
15 mainder of that part of the base period during which
16 neither the successor nor any predecessor thereof was
17 in existence, and divided by 365.

18 **"SEC. 757. COMPUTATION OF LOWEST INVESTED CAPITAL**
19 **IN CONNECTION WITH EXCHANGES.**

20 "(a) LOWEST INVESTED CAPITAL OF TRANSFEROR.—
21 "(1) TAXABLE YEAR OF EXCHANGE.—The lowest
22 invested capital of a transferor upon an exchange after
23 the beginning of its first taxable year under this sub-
24 chapter shall, for the taxable year in which the exchange
25 takes place, be the sum of—

1 "(A) Its lowest invested capital immediately
2 preceding the exchange multiplied by the number
3 of days in the taxable year up to and including the
4 day of the exchange, plus
5 "(B) The amount computed under paragraph
6 (2) (A) of this subsection multiplied by the
7 number of days in the taxable year remaining after
8 the day of the exchange,
9 divided by the number of days in the taxable year.
10 "(2) TAXABLE YEARS AFTER EXCHANGE.—The
11 lowest invested capital of a transferor upon an exchange
12 after the beginning of its first taxable year under this
13 subchapter shall, for any taxable year after the year in
14 which the exchange takes place, be whichever of the
15 following amounts is the smaller:
16 "(A) An amount which bears the same ratio
17 to the lowest invested capital of the transferor im-
18 mediately preceding the exchange as its daily in-
19 vested capital for the day after the exchange bears
20 to its daily invested capital for the day of the ex-
21 change; or
22 "(B) The smallest invested capital for any
23 year preceding such taxable year, beginning with
24 the taxable year of the exchange.

1 "(b) LOWEST INVESTED CAPITAL OF TRANSFEREE.—

2 "(1) TAXABLE YEAR OF EXCHANGE.—The lowest
3 invested capital of a transferee upon an exchange after
4 the beginning of the first taxable year under this sub-
5 chapter of a transferor upon such exchange, shall, for
6 the taxable year in which the exchange took place, be
7 the sum of—

8 "(A) Its lowest invested capital immediately
9 preceding the exchange multiplied by the number
10 of days in the taxable year up to and including
11 the day of the exchange, plus

12 "(B) The amount computed under paragraph
13 (2) (A) of this subsection multiplied by the num-
14 ber of days in the taxable year remaining after the
15 day of the exchange,

16 divided by the number of days in the taxable year. For
17 the purposes of this paragraph and subsection (c) of
18 this section 'exchange' includes a liquidation described
19 in subsection (b) (3), and such exchange shall be
20 deemed to have taken place on the day such liquidation
21 was completed.

22 "(2) TAXABLE YEARS AFTER EXCHANGE.—The
23 lowest invested capital of a transferee upon an exchange
24 after the beginning of the first taxable year under this
25 subchapter of a transferor upon such exchange, shall,

1 for any taxable year after the year in which the ex-
2 change took place, be whichever of the following
3 amounts is the smaller:
4 "(A) Its lowest invested capital immediately
5 preceding the exchange increased by an amount
6 equal to the excess of the lowest invested capital
7 of the transferor immediately preceding the exchange
8 over the amount computed under subsection (a)
9 (2) (A) with respect to such transferor; or
10 "(B) Its smallest invested capital for any year
11 preceding such taxable year, beginning with the
12 taxable year of the exchange.
13 "(3) TAXABLE YEARS AFTER EXCHANGE IN CASE
14 OF CORPORATION RECEIVING PROPERTY UNDER SEC-
15 TION 112 (b) (6).—Upon the receipt by a corporation
16 during any taxable year under this subchapter of prop-
17 erty in complete liquidation of another corporation, gain
18 or loss upon which is not recognized by reason of sec-
19 tion 112 (b) (6), the lowest invested capital of the
20 corporation receiving such property for any taxable year
21 after the liquidation is completed shall be an amount
22 equal to its lowest invested capital immediately preced-
23 ing the completion of the liquidation, increased by an
24 amount equal to the lowest invested capital of such other
25 corporation immediately preceding the completion of

1 such liquidation, if previously and after the beginning of
2 the first taxable year under this subchapter of the cor-
3 poration receiving such property such corporation was a
4 transferor upon an exchange with respect to which such
5 other corporation was a transferee.

6 "(c) LOWEST INVESTED CAPITAL IN CASE OF TWO
7 OR MORE EXCHANGES IN SAME TAXABLE YEAR.—

8 "(1) If a transferor upon an exchange is in the
9 same taxable year involved in more than one exchange
10 (either as transferor or transferee), its lowest invested
11 capital for such taxable year shall be the amount deter-
12 mined under subsection (a) (1) with respect to the
13 last exchange in such taxable year. Its lowest invested
14 capital immediately preceding any exchange in such tax-
15 able year subsequent to the first exchange therein shall
16 be the amount computed under subsection (a) (1) with
17 respect to the immediately preceding exchange as if
18 the taxable year closed on the day of such subsequent
19 exchange.

20 "(2) If a transferee upon an exchange is in the
21 same taxable year involved in more than one exchange
22 (either as transferee or transferor), its lowest invested
23 capital for such taxable year shall be the amount deter-
24 mined under subsection (b) (1) with respect to the last
25 exchange in such taxable year. Its lowest invested

1 capital immediately preceding any exchange in such
2 taxable year subsequent to the first exchange therein
3 shall be the amount computed under subsection (b) (1)
4 with respect to the immediately preceding exchange as
5 if the taxable year closed on the day of such subsequent
6 exchange.

7 "(3) If a transferor or transferee upon an ex-
8 change is in the same taxable year involved in more
9 than one exchange (either as transferor or transferee),
10 its lowest invested capital for any taxable year after
11 the taxable year in which such exchanges took place
12 shall be the amount computed under subsection (a)
13 (2), or (b) (2) or (3), as the case may be, with
14 respect to the last such exchange.

15 "SEC. 758. COMPUTATION OF BASE PERIOD PERCENTAGE
16 IN CONNECTION WITH EXCHANGES.

17 "(a) TRANSFEREE FOR TAXABLE YEAR OF EX-
18 CHANGE.—In the case of a transferee upon an exchange after
19 the beginning of the first taxable year under this sub-
20 chapter of the transferor upon such exchange, for the tax-
21 able year in which the exchange takes place the transferee
22 shall be deemed to have a base period percentage (whether
23 or not it was in existence during the base period) equal to
24 the percentage which the sum of—

25 "(1) An amount equal to the transferor's base

1 period percentage immediately preceding the exchange
2 of the excess of its lowest invested capital for the taxable
3 year over its lowest invested capital immediately pre-
4 ceding the exchange, plus

5 "(2) An amount equal to the transferee's base
6 period percentage (immediately preceding the ex-
7 change) of its lowest invested capital immediately pre-
8 ceding the exchange

9 is of the transferee's lowest invested capital for the taxable
10 year in which the exchange takes place.

11 "(b) TRANSFEREE FOR TAXABLE YEARS AFTER EX-
12 CHANGE.—In the case of a transferee upon an exchange after
13 the beginning of the first taxable year under this subchapter
14 of the transferor upon such exchange, for each taxable year
15 following the year of the exchange the transferee shall be
16 deemed to have a base period percentage (whether or not it
17 was in existence during the base period) equal to the per-
18 centage which the sum of—

19 "(1) An amount equal to the transferor's base
20 period percentage of the excess of the transferor's lowest
21 invested capital immediately preceding the exchange over
22 the amount computed under section 757 (a) (2) (A),
23 plus

24 "(2) An amount equal to the transferee's base
25 period percentage immediately preceding the exchange

1 of its lowest invested capital immediately preceding the
2 exchange
3 is of the amount computed under section 757 (b) (2) (A).
4 "(c) BASE PERIOD PERCENTAGE IN CASE OF TWO OR
5 MORE EXCHANGES IN SAME TAXABLE YEAR.—
6 "(1) If a transferee upon an exchange is in the same
7 taxable year involved in more than one exchange as a
8 transferee, its base period percentage for such taxable
9 year shall be the amount determined under subsection
10 (a) with respect to the last such exchange in such tax-
11 able year. Its base period percentage immediately pre-
12 ceding any exchange in such taxable year subsequent to
13 the first exchange therein shall be the amount computed
14 under subsection (a) with respect to the immediately
15 preceding exchange as if in the computation of the trans-
16 feree's lowest invested capital for the taxable year such
17 taxable year closed on the day of such subsequent
18 exchange.
19 "(2) If a transferee upon an exchange is in the
20 same taxable year involved in more than one exchange as
21 a transferee, its base period percentage for any taxable
22 year after the taxable year in which such exchanges took
23 place shall be the amount computed under subsection (b)
24 with respect to the last such exchange.

1 "SEC. 759. COMPUTATION OF PREFERENTIAL RATE AMOUNT
2 IN CONNECTION WITH EXCHANGES.
3 "(a) PREFERENTIAL RATE AMOUNT OF TRANSFEROR.—
4 "(1) TAXABLE YEAR OF EXCHANGE.—In the case
5 of a transferor upon an exchange after the beginning of
6 its first taxable year under this subchapter, its preferen-
7 tial rate amount for the taxable year in which the ex-
8 change takes place shall be the sum of—
9 "(A) Its preferential rate amount immediately
10 preceding the exchange multiplied by the number
11 of days in the taxable year up to and including the
12 day of the exchange, plus
13 "(B) Its preferential rate amount for the tax-
14 able year after the exchange,
15 divided by the number of days in the taxable year.
16 "(2) TAXABLE YEARS AFTER EXCHANGE INVOLV-
17 ING CONTROL.—In the case of a transferor upon an
18 exchange after the beginning of its first taxable year
19 under this subchapter, if immediately after the exchange
20 the transferor or its shareholders, or both, are in control
21 of the transferee, the transferor's preferential rate
22 amount for any taxable year after the taxable year in
23 which the exchange takes place shall be an amount
24 which is a percentage of its preferential rate amount im-
25 mediately preceding the exchange equal to the per-

1 centage which its daily invested capital for the day after
2 the exchange is of its daily invested capital for the day
3 of the exchange.

4 "(3) TAXABLE YEARS AFTER EXCHANGE NOT IN-
5 VOLVING CONTROL.—In the case of a transferor upon
6 an exchange (other than a transferor described in para-
7 graph (4) of this subsection) after the beginning of its
8 first taxable year under this subchapter, if immediately
9 after the exchange no transferor or its shareholders, or
10 both, upon the exchange are in control of the transferee,
11 and if the shareholders of the transferee immediately
12 preceding the exchange are not in control of the trans-
13 feree immediately after the exchange, the transferor's
14 preferential rate amount for any taxable year after the
15 exchange shall be the excess, if any, of the sum of the
16 transferor's preferential rate amount and the transferee's
17 preferential rate amount immediately preceding the
18 exchange over $500,000.

19 "(4) TAXABLE YEARS AFTER CERTAIN EX-
20 CHANGES UNDER SECTION 112 (b) (5).—In the case of
21 an exchange after the beginning of the first taxable year
22 under this subchapter of any transferor or transferee
23 upon such exchange, involving two or more transferors,
24 or one or more transferors and one or more other per-

1 sons, if immediately after the exchange no one of such
2 transferors, or its shareholders, or both, and no one or
3 more of such other persons are in control of the trans-
4 feree and if such exchange is an exchange described in
5 section 112 (b) (5) or so much of section 112 (c)
6 or 112 (e) as refers to section 112 (b) (5), the prefer-
7 ential rate amount of any such transferor for any taxable
8 year after the exchange shall be an amount equal to its
9 preferential rate amount immediately preceding the ex-
10 change—

11 "(A) Minus an amount which bears the same
12 ratio to its preferential rate amount immediately
13 preceding the exchange as the excess of its daily
14 invested capital for the day of the exchange over its
15 daily invested capital for the day after the exchange
16 bears to its daily invested capital for the day of the
17 exchange, and

18 "(B) Plus an amount which bears the same
19 ratio to the excess of the sum of the amounts com-
20 puted under subparagraph (A) with respect to
21 each transferor over $500,000, as the amount com-
22 puted under subparagraph (A) with respect to
23 such transferor bears to the sum of the amounts
24 computed under such subparagraph with respect to
25 each transferor.

"(b) PREFERENTIAL RATE AMOUNT OF TRANSFEREE.—

"(1) TAXABLE YEAR OF EXCHANGE IN CASE OF CONTROL.—In the case of a transferee upon an exchange after the beginning of the first taxable year under this subchapter of a transferor upon such exchange the transferee's preferential rate amount for the taxable year in which the exchange takes place shall be the sum of—

"(A) Its preferential rate amount immediately preceding the exchange or its invested capital (computed as if the taxable year closed on the day preceding the day of the exchange), whichever is the smaller, multiplied by the number of days in the taxable year up to and including the day of the exchange, plus

"(B) Its preferential rate amount for the taxable year after the exchange multiplied by the number of days in the taxable year remaining after the day of the exchange,

divided by the number of days in the taxable year. For the purposes of this paragraph and subsection (c) of this section 'exchange' includes a liquidation described in paragraph (5) of this subsection, and such exchange shall be deemed to have taken place on the day such liquidation was completed.

1 "(2) TAXABLE YEARS AFTER EXCHANGE INVOLV-
2 ING CONTROL.—In the case of a transferee upon an ex-
3 change after the beginning of the first taxable year
4 under this subchapter of a transferor upon such ex-
5 change, if immediately after the exchange any trans-
6 feror upon such exchange or its shareholders, or both,
7 are in control of the transferee, the transferee's preferen-
8 tial rate amount for any taxable year after the exchange
9 shall be an amount which is a percentage of such trans-
10 feror's preferential rate amount immediately preceding
11 the exchange equal to the percentage which the excess
12 of the transferee's daily invested capital for the day after
13 the exchange over its daily invested capital for the day of
14 the exchange is of such transferor's daily invested capital
15 for the day of the exchange.

16 "(3) TAXABLE YEARS AFTER EXCHANGE NOT IN-
17 VOLVING CONTROL.—In the case of a transferee upon an
18 exchange (other than a transferee described in paragraph
19 (4) of this subsection) after the beginning of the first
20 taxable year under this subchapter of a transferor upon
21 such exchange, if immediately after the exchange no
22 transferor or its shareholders, or both, are in control of
23 the transferee, and if the shareholders of the transferee
24 immediately preceding the exchange are not in control
25 of the transferee immediately after the exchange, the

1 transferee's preferential rate amount for any taxable
2 year after the exchange shall be an amount equal to
3 (A) the sum of the transferor's preferential rate amount
4 and the transferee's preferential rate amount immediately
5 preceding the exchange, or (B) $500,000, whichever
6 is the smaller.

7 "(4) TAXABLE YEARS AFTER CERTAIN EX-
8 CHANGES UNDER SECTION 112 (b) (5).—In the case
9 of an exchange described in subsection (a) (4) of this
10 section, the preferential rate amount of the transferee
11 upon such exchange for any taxable year after the
12 exchange shall be an amount equal (A) to the sum
13 of the amounts computed under subparagraph (A) of
14 such subsection with respect to each transferor or (B)
15 $500,000, whichever is the smaller.

16 "(5) TAXABLE YEARS AFTER LIQUIDATION IN
17 CASE OF CORPORATION RECEIVING PROPERTY UNDER
18 SECTION 112 (b) (6).—Upon the receipt by a corpora-
19 tion during any taxable year under this subchapter of
20 property in complete liquidation of another corporation,
21 gain or loss upon which is not recognized by reason
22 of section 112 (b) (6), the preferential rate amount
23 of the corporation receiving such property for any tax-
24 able year after the liquidation is completed shall be an
25 amount equal to its preferential rate amount immediately

1 preceding the completion of the liquidation increased,
2 but in no case to an amount above $500,000, by an
3 amount equal to the preferential rate amount of such
4 other corporation immediately preceding the completion
5 of such liquidation, if previously and after the beginning
6 of the first taxable year under this subchapter of the
7 corporation receiving such property such corporation
8 was a transferor upon an exchange with respect to which
9 such other corporation was a transferee.

10 "(c) PREFERENTIAL RATE AMOUNT IN CASE OF TWO
11 OR MORE EXCHANGES IN SAME TAXABLE YEAR.—

12 "(1) If a transferor upon an exchange is in the
13 same taxable year involved in more than one exchange
14 (either as transferor or transferee), its preferential rate
15 amount for such taxable year shall be the amount deter-
16 mined under subsection (a) (1) with respect to the
17 last exchange in such taxable year. Its preferential rate
18 amount immediately preceding any exchange in such
19 taxable year subsequent to the first exchange therein
20 shall be the amount computed under subsection (a) (1)
21 with respect to the immediately preceding exchange as
22 if the taxable year closed on the day of such subsequent
23 exchange.

24 "(2) If a transferee upon an exchange is in the
25 same taxable year involved in more than one exchange
26 (either as transferee or transferor), its preferential rate

1 amount for such taxable year shall be the amount deter-
2 mined under subsection (b) (1) with respect to the last
3 exchange in such taxable year. Its preferential rate
4 amount immediately preceding any exchange in such tax-
5 able year subsequent to the first exchange therein shall
6 be the amount computed under subsection (b) (1) with
7 respect to the immediately preceding exchange as if the
8 taxable year closed on the day of such subsequent
9 exchange.

10 "(3) If a transferor or transferee upon an exchange
11 is in the same taxable year involved in more than one
12 exchange (either as transferor or transferee), its pref-
13 erential rate amount for any taxable year after the tax-
14 able year in which such exchanges took place shall be
15 the amount computed under subsection (a) (2), (3),
16 or (4), or (b) (2), (3), (4), or (5), as the case
17 may be, with respect to the last such exchange.

18 **"SEC. 760. COMPUTATION OF BORROWED CAPITAL BASES**
19 **IN CONNECTION WITH CERTAIN EXCHANGES.**

20 "(a) FIRST BORROWED CAPITAL BASE OF TRANS-
21 FEROR OR TRANSFEREE.—The first borrowed capital base
22 of any transferor or transferee whose second borrowed
23 capital base is computed under this section shall be an
24 amount equal to 10 per centum of such second borrowed
25 capital base.

1 "(b) SECOND BORROWED CAPITAL BASE OF TRANS-
2 FEROR UPON EXCHANGE INVOLVING CONTROL.—In the
3 case of a transferor upon an exchange after the beginning of
4 its first taxable year under this subchapter, if immediately
5 after the exchange the transferor or its shareholders, or both,
6 are in control of the transferee, the transferor's second bor-
7 rowed capital base for any day after the exchange shall be—
8 "(1) If such transferor had borrowed capital for
9 the day of the exchange, an amount equal to its equity
10 invested capital for the day after the exchange—
11 "(A) Plus an amount which is a percentage of
12 the excess of its second borrowed capital base im-
13 mediately preceding the exchange over its equity
14 invested capital for the day of the exchange, equal
15 to the percentage which the borrowed capital not
16 acquired by the transferee from the transferor as a
17 result of the exchange is of the transferor's borrowed
18 capital for the day of the exchange, or
19 "(B) Minus an amount which is a percentage of
20 the excess of its equity invested capital for the
21 day of the exchange over its second borrowed capital
22 base immediately preceding the exchange, equal to
23 the percentage which the borrowed capital not ac-
24 quired by the transferee from the transferor as a
25 result of the exchange is of the transferor's bor-
26 rowed capital for the day of the exchange.

1 "(2) If such transferor had no borrowed capital
2 for the day of the exchange, an amount equal to its
3 equity invested capital for the day after the exchange—
4 "(A) Plus an amount which is a percentage
5 of the excess of its second borrowed capital base
6 immediately preceding the exchange over its equity
7 invested capital for the day of the exchange, equal
8 to the percentage which its daily invested capital
9 for the day after the exchange is of its daily invested
10 capital for the day of the exchange, or
11 "(B) Minus an amount which is a percentage
12 of the excess of its equity invested capital for the
13 day of the exchange over its second borrowed capital
14 base immediately preceding the exchange, equal to
15 the percentage which its equity invested capital for
16 the day after the exchange is of its equity invested
17 capital for the day of the exchange.
18 "(c) TRANSFEROR UPON EXCHANGE NOT INVOLVING
19 CONTROL.—In the case of a transferor (other than a trans-
20 feror described in subsection (d)), upon an exchange after
21 the beginning of its first taxable year under this subchapter,
22 if immediately after the exchange no transferor or its share-
23 holders, or both, upon the exchange are in control of the
24 transferee, and if the shareholders of the transferee imme-
25 diately preceding the exchange are not in control of the

1 transferee immediately after the exchange, the transferor's
2 second borrowed capital base for any day after the exchange
3 shall be the excess, if any, of the sum of the transferor's
4 second borrowed capital base and the transferee's second
5 borrowed capital base immediately preceding the exchange
6 over $1,000,000.

7 "(d) TRANSFEROR UPON CERTAIN EXCHANGES UN-
8 DER SECTION 112 (b) (5).—In the case of an exchange
9 after the beginning of the first taxable year under this sub-
10 chapter of any transferor or transferee upon such exchange,
11 involving two or more transferors, or one or more transferors
12 and one or more other persons, if immediately after the
13 exchange no one of such transferors, or its shareholders, or
14 both, and no one or more of such other persons, are in control
15 of the transferee, and if such exchange is an exchange de-
16 scribed in section 112 (b) (5) or so much of section 112 (c)
17 or 112 (e) as refers to section 112 (b) (5), the second
18 borrowed capital base of any such transferor for any day
19 after the exchange shall be an amount equal to its second
20 borrowed capital base immediately preceding the exchange—

21 "(1) Minus an amount equal to the excess of its
22 second borrowed capital base immediately preceding the
23 exchange over an amount computed under subsection
24 (b) (1) or (2), as the case may be, and

25 "(2) Plus an amount which bears the same ratio

1 to the excess over $1,000,000 of the sum of the amounts
2 computed under paragraph (1) of this subsection with
3 respect to each transferor, as the amount computed
4 under paragraph (1) of this subsection with respect to
5 such transferor bears to the sum of the amounts computed
6 under such paragraph with respect to each transferor.
7 "(e) TRANSFEREE UPON EXCHANGE INVOLVING CON-
8 TROL.—In the case of a transferee upon an exchange after
9 the beginning of the first taxable year under this subchapter
10 of a transferor upon such exchange, if immediately after the
11 exchange the transferor or its shareholders, or both, are in
12 control of the transferee, the transferee's second borrowed
13 capital base for any day after the exchange shall be—
14 "(1) If the transferor had borrowed capital for
15 the day of the exchange, an amount equal to the equity
16 invested capital acquired by the transferee as a result
17 of the exchange—
18 "(A) Plus an amount which is a percentage of
19 the excess of the transferor's second borrowed capi-
20 tal base immediately preceding the exchange over
21 the transferor's equity invested capital for the day
22 of the exchange, equal to the percentage which the
23 borrowed capital acquired by the transferee as a
24 result of the exchange is of the transferor's bor-
25 rowed capital for the day of the exchange, or

1 "(B) Minus an amount which is a percentage
2 of the excess of the transferor's equity invested
3 capital for the day of the exchange over the trans-
4 feror's second borrowed capital base immediately
5 preceding the exchange, equal to the percentage
6 which the borrowed capital acquired by the trans-
7 feree as a result of the exchange is of the borrowed
8 capital of the transferor for the day of the exchange.
9 "(2) If the transferor had no borrowed capital for
10 the day of the exchange, an amount equal to the equity
11 invested capital acquired by the transferee as a result of
12 the exchange—
13 "(A) Plus an amount which is a percentage of
14 the excess of the transferor's second borrowed capital
15 base immediately preceding the exchange over the
16 transferor's equity invested capital for the day of the
17 exchange, equal to the percentage which the equity
18 invested capital acquired by the transferee as a re-
19 sult of the exchange is of the transferor's equity in-
20 vested capital for the day of the exchange, or
21 "(B) Minus an amount which is a percentage of
22 the excess of the transferor's equity invested capital
23 for the day of the exchange over the transferor's sec-
24 ond borrowed capital base immediately preceding the

1 exchange, equal to the percentage which the equity
2 invested capital acquired by the transferee as a result
3 of the exchange is of the transferor's equity invested
4 capital for the day of the exchange.

5 "(f) TRANSFEREE UPON EXCHANGE NOT INVOLVING
6 CONTROL.—In the case of a transferee upon an exchange
7 (other than a transferee described in subsection (g)) after
8 the beginning of the first taxable year under this subchapter
9 of a transferor upon such exchange, if immediately after the
10 exchange no transferor or its shareholders, or both, are in
11 control of the transferee, and if the shareholders of the trans-
12 feree immediately preceding the exchange are not in control
13 of the transferee immediately after the exchange, the trans-
14 feree's second borrowed capital base for any day after the
15 exchange shall be an amount equal to (1) the sum of the
16 transferor's second borrowed capital base and the trans-
17 feree's second borrowed capital base immediately preceding
18 the exchange, or (2) $1,000,000, whichever is the smaller.

19 "(g) TRANSFEREE UPON CERTAIN EXCHANGES
20 UNDER SECTION 112 (b) (5).—In the case of an exchange
21 described in subsection (d) of this section, the second bor-
22 rowed capital base of the transferee upon such exchange for
23 any day after the exchange shall be an amount equal to (A)
24 the sum of the amounts computed under paragraph (1) of

1 such subsection with respect to each transferor or (B)
2 $1,000,000, whichever is the smaller.
3 "(h) SECOND BORROWED CAPITAL BASE OF COR-
4 PORATION RECEIVING PROPERTY UNDER SECTION 112
5 (b) (6).—Upon the receipt by a corporation during any
6 taxable year under this subchapter of property in complete
7 liquidation of another corporation, gain or loss upon which
8 is not recognized by reason of section 112 (b) (6), the
9 second borrowed capital base of the corporation receiving
10 such property for any day after the liquidation is completed
11 shall be an amount equal to its second borrowed capital base
12 for the day the liquidation is completed increased, but in no
13 case to an amount above $1,000,000, by an amount equal to
14 the second borrowed capital base of such other corporation
15 for the day the liquidation is completed, if previously and
16 after the beginning of the first taxable year under this sub-
17 chapter of the corporation receiving such property such cor-
18 poration was a transferor upon an exchange with respect to
19 which such other corporation was a transferee."

20 **TITLE II—AMORTIZATION DEDUCTION**

21 **SEC. 201. ALLOWANCE OF AMORTIZATION DEDUCTION.**

22 Section 23 of the Internal Revenue Code is amended
23 by inserting at the end thereof the following new subsection:
24 "(t) AMORTIZATION DEDUCTION.—The deduction for
25 amortization provided in section 124."

1 **SEC. 202. COMPUTATION OF AMORTIZATION DEDUCTION.**

2 The Internal Revenue Code is amended by inserting after
3 section 123 the following new section:

4 **"SEC. 124. AMORTIZATION DEDUCTION.**

5 "(a) GENERAL RULE.—Every corporation, at its elec-
6 tion, shall be entitled to a deduction with respect to the
7 amortization of the adjusted basis of any emergency facility
8 (as defined in subsection (e)), based on a period of sixty
9 months. Such amortization deduction shall be an amount,
10 with respect to each month of such period within the tax-
11 able year, equal to the adjusted basis of the facility at the
12 end of such month divided by the number of months (in-
13 cluding the month for which the deduction is computed)
14 remaining in the period. Such adjusted basis at the end of
15 the month shall be computed without regard to the amorti-
16 zation deduction for such month. The amortization deduc-
17 tion above provided with respect to any month shall, except
18 to the extent provided in subsection (g) of this section, be
19 in lieu of the deduction with respect to such facility for such
20 month provided by section 23 (l), relating to exhaustion,
21 wear and tear, and obsolescence. The sixty-month period
22 shall begin as to any emergency facility, at the election of
23 the taxpayer, with the month following the month in which
24 the facility was completed or acquired, or with the suc-
25 ceeding taxable year.

1 "(b) ELECTION OF AMORTIZATION.—The election of
2 the taxpayer to take the amortization deduction and to begin
3 the sixty-month period with the month following the month
4 in which the facility was completed or acquired shall (except
5 as provided in subsection (d) (3)) be made only by a state-
6 ment to that effect in its return for the taxable year in which
7 the facility was completed or acquired. Its election to take
8 the amortization deduction and to begin such period with
9 the taxable year succeeding such year shall be made only
10 by a statement to that effect in its return for such succeeding
11 taxable year.

12 "(c) TERMINATION OF AMORTIZATION DEDUC-
13 TION.—A taxpayer which has elected under subsection (b)
14 to take the amortization deduction provided in subsection (a)
15 may, at any time after making such election, discontinue the
16 amortization deductions with respect to the remainder of
17 the amortization period, such discontinuance to begin as of
18 the beginning of any month specified by the taxpayer in a
19 notice in writing filed with the Commissioner before the
20 beginning of such month. The deduction provided under
21 section 23 (l) shall be allowed, beginning with the first
22 month as to which the amortization deduction is not appli-
23 cable, and the taxpayer shall not (except as provided in
24 subsection (d)) be entitled to any further amortization
25 deductions with respect to such emergency facility.

1 "(d) TERMINATION OF AMORTIZATION PERIOD.—

2 "(1) If the President has proclaimed the ending of
3 the emergency period (as defined in subsection (e)),
4 or if the Secretary of War or the Secretary of the Navy
5 has, in accordance with regulations prescribed by the
6 President, certified to the Commissioner that an emer-
7 gency facility ceased, on the date specified in the cer-
8 tificate, to be necessary in the interest of national de-
9 fense during the emergency period, and if the date of
10 such proclamation or the date specified in such certificate
11 occurs within sixty months from the beginning of the
12 amortization period with respect to such emergency
13 facility, then the taxpayer may elect (in accordance
14 with paragraph (4) of this subsection) to terminate the
15 amortization period with respect to such emergency
16 facility as of the end of the month in which such proc-
17 lamation was issued or in which occurred the date
18 specified in such certificate, whichever is the earlier.
19 In such case the amortization period with respect to
20 such facility shall end with the end of such month in
21 lieu of the end of the sixty-month period.

22 "(2) If the date of the proclamation or the date
23 specified in the certificate referred to in paragraph (1)
24 of this subsection occurs within sixty months from the
25 beginning of the amortization period with respect to such

emergency facility and after the beginning of the month which the taxpayer has previously fixed under subsection (c) for the taking, in lieu of the amortization deduction provided in this section, of the deduction allowed by section 23 (l), the taxpayer may elect (in accordance with paragraph (4) of this subsection) to terminate the amortization period with respect to such emergency facility as of the end of the month in which such proclamation was issued or in which occurred the date specified in such certificate, whichever is the earlier. In such case the amortization period with respect to such facility shall end with the end of such month in lieu of the end of the sixty-month period, and the termination of the amortization deduction under subsection (c) shall be disregarded.

"(3) In the case of a taxpayer which has not in either of its returns specified in subsection (b) elected to take an amortization deduction with respect to an emergency facility, if the date of the proclamation or the date specified in the certificate, referred to in paragraph (1) of this subsection, whichever is earlier, is before the expiration of sixty months from the last day of the month in which such emergency facility was completed or acquired, then the taxpayer may elect (in accordance with paragraph (4) of this subsection) the