

21-24.) Certain credits are allowed against net income and against the amount of the tax. (See sections 26, 131, and 205.) The tax is payable upon the basis of returns rendered by the corporations liable thereto, except that in some cases, it is to be paid at the source of the income. (See also sections 47, 52, 53, 144, and 235.) For the income tax on life insurance companies, see sections 201-203; on insurance companies other than life or mutual, section 204. Mutual insurance companies other than life are taxed under section 13. (See section 207.) As to foreign corporations, see sections 53 and 231-238; as to domestic corporations deriving income from sources within possessions of the United States, see section 251; as to China Trade Act corporations, see sections 261-264. For surtax on corporations improperly accumulating surplus, see section 102. As to surtax on personal holding companies, see section 351. For what the term "corporation" includes and for the difference between domestic and foreign corporations, see section 801 (a) (2).

CHAPTER III

GROSS INCOME—NET INCOME

Part II—Computation of net income

SEC. 21. NET INCOME.

"Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

ART. 21-1. **Meaning of net income.**—The tax imposed by Title I is upon income. **Neither income exempted by statute or fundamental law, nor expenses incurred in connection therewith, other than interest, enter into the computation of net income as defined by section 21.** (See section 24 (a) (5).) In the computation of the tax various classes of income must be considered:

(a) Income (in the broad sense), meaning all wealth which flows in to the taxpayer other than as a mere return of capital. It includes the forms of income specifically described as gains and profits, including gains derived from the sale or other disposition of capital assets. Cash receipts alone do not always accurately reflect income, for the Act recognizes as income-determining factors other items, among which are inventories, accounts receivable, property exhaustion, and accounts payable for expenses incurred. (See sections 22, 23, and 117.)

(b) Gross income, meaning income (in the broad sense) less income which is by statutory provision or otherwise exempt from the tax imposed by the Act. (See section 22.)

(c) Net income, meaning gross income less statutory deductions. The statutory deductions are in general, though not exclusively, expenditures, other than capital expenditures, connected with the production of income. (See sections 23 and 24.)

(d) Net income less credits. (See sections 25 and 26.)

The normal tax and surtax imposed by sections 11 and 12, respectively, on individuals and the tax imposed by section 13 on corporations are imposed upon net income less certain credits. Although taxable net income is a statutory conception, it follows, subject to certain modifications as to exemptions and as to deductions for partial losses in some cases, the lines of commercial usage. Subject to these modifications statutory net income is commercial net income. This appears from the fact that ordinarily it is to be computed in

CHAPTER XV

DISTRIBUTIONS BY CORPORATIONS—DIVIDENDS

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) **Definition of dividend.**—The term "dividend" when used in this title (except in section 203 (a) (4) and section 207 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913.

(b) **Source of distributions.**—For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113.

(c) **Distributions in liquidation.**—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. Despite the provisions of section 117 (a), 100 per centum of the gain so recognized shall be taken into account in computing net income. In the case of amounts distributed (whether before January 1, 1934, or on or after such date) in partial liquidation (other than a distribution within the provisions of subsection (h) of this section of stock or securities in connection with a reorganization) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of subsection (b) of this section for the purpose of determining the taxability of subsequent distributions by the corporation.

(d) **Other distributions from capital.**—If any distribution (not in partial or complete liquidation) made by a corporation to its shareholders is not out of increase in value of property accrued before March 1, 1913, and is not out of earnings or profits, then the amount of such distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113, and if in excess of such basis, such excess shall be taxable in the same manner as a gain from the sale or exchange of property.

(e) **Distributions by personal service corporations.**—Any distribution made by a corporation, which was classified as a personal service corporation under the provisions of the Revenue Act of 1918 or the Revenue Act of 1921, out of its earnings or profits which were taxable

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in accordance with the provisions of section 218 of the Revenue Act of 1918 or section 218 of the Revenue Act of 1921, shall be exempt from tax to the distributees.

(f) **Stock dividends.**—A stock dividend shall not be subject to tax.

(g) **Redemption of stock.**—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

(h) **Distribution of stock on reorganization—Effect on future distributions.**—The distribution before January 1, 1934, in pursuance of a plan of reorganization, by or on behalf of a corporation a party to the reorganization, of its stock or securities or stock or securities in a corporation a party to the reorganization, if no gain to the distributee from the receipt of such stock or securities was recognized by law, shall not be considered a distribution of earnings or profits within the meaning of this section for the purpose of determining the taxability of subsequent distributions by the corporation. As used in this subsection, the terms "reorganization" and "party to the reorganization" shall have the meanings assigned to such terms in section 112 of the Revenue Act of 1932.

(i) **Definition of partial liquidation.**—As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

ARR. 115-1. Dividends.—The term "dividends" for the purpose of Title I (except when used in sections 203 (a) (4) and 207 (c) (1)) comprises any distribution in the ordinary course of business, even though extraordinary in amount, made by a domestic or foreign corporation to its shareholders out of its earnings or profits accumulated since February 28, 1913. Among the items entering into the computation of corporate "earnings or profits" for a particular period are all income exempted by statute, income not taxable by the Federal Government under the Constitution, as well as all items includible in gross income under section 22 (a) of the Act or corresponding provisions of prior Acts. Gains and losses within the purview of section 112, are brought into the earnings and profits account at the time and to the extent such gains and losses are recognized under that section. Although interest on State bonds and certain other obligations is not taxable when received by a corporation, when distributed to shareholders in dividends is taxable to the same extent as other dividends.

A taxable distribution made by a corporation to its shareholders shall be included in the gross income of the distributees when the