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Turner Vann Adams

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are the state's interests "independent of and behind the titles of its citizens."⁴⁹ The court's failure to answer this question exposes an anomalous situation: The court as a matter of law has concluded, for purposes of standing, that independent interests of the state are present; however, the court lends no aid as to the identity of these interests for purposes of damages. Apparently the State of Hawaii also found this problem troublesome, for after twice fully briefing and arguing the *parens patriae* issue, she had not alleged the precise extent of her monetary damages.⁵⁰

A recent suit brought by North Carolina may help bring about a solution.⁵¹ Relying largely on *Standard Oil*, North Carolina has filed suit against five drug companies for excessively priced drugs. Two types of monetary relief are being sought: 200,000 dollars for loss of tax revenue from the sale of taxed commodities that would have been purchased but for the over-priced and untaxed drugs; and twenty million dollars for general economic injury caused by the diversion of money by the drug companies from the state's economy.

Despite the problem of damages, the concept of *parens patriae* has great potential in the area of consumer protection. California, for instance, recently filed an antitrust action against automobile manufacturers for conspiracy to suppress the development of anti-pollution devices on automobiles.⁵² Cases such as those brought by California, North Carolina, and Hawaii should not be dismissed for lack of standing. The *parens patriae* concept, while not denying private substantive rights, gives the public a voice in matters of utmost importance to society.

WILLIAM MACNIDER TROTT

Income Tax—Charitable Contributions under the Tax Reform Act of 1969

In a message to Congress on April 22, 1969, President Nixon emphasized the need for tax reform in order to "lighten the burden on those who pay too much, and increase the taxes on those who pay too little."¹

⁴⁹ *Georgia v. Tennessee Copper Co.*, 206 U.S. 230, 237 (1907).

⁵⁰ 301 F. Supp. at 984.

⁵¹ Telephone interview with Mr. Jean A. Benoy, Deputy Attorney General of North Carolina, March 17, 1970.

⁵² Telephone interview with Mr. Benoy, note 51 *supra*.

¹ *Hearings on H.R. 13270 Before the House Committee on Ways and Means*, 91st Cong., 1st Sess. 5047 (1969) [hereinafter cited as *1969 Hearings*].

After eight months, Congress finally passed the Tax Reform Act of 1969, which was signed by the President on December 30, 1969, and became Public Law 91-172.² One of the most important changes proposed by both the President³ and the Treasury⁴ pertained to charitable deductions. Many of their recommendations⁵ regarding reform in this area were adopted and appear in the final version of the Act. This note will point out the major changes in the law of charitable deductions and analyze specifically the tax consequences of the Act for the individual taxpayer who makes a charitable contribution of appreciated property.

The most apparent change in the area of charitable deductions is the provision by which the maximum limitation for deductions from an individual's income for gifts to public charities is increased from thirty per cent to fifty per cent of adjusted gross income. Section 170(b)(1) of the Internal Revenue Code, as amended, states that "[i]n the case of an individual . . . any charitable contribution to [public charities] shall be allowed [as a deduction against ordinary income] to the extent that the aggregate of such contributions does not exceed fifty per cent of the taxpayer's contribution base for the taxable year."⁶ The term "contribution base" is defined as "adjusted gross income (computed without regard to any net operating loss carryback to the taxable year under section 172)."⁷ Under the old law, charitable contributions had to be made to certain specific organizations in order to qualify for the thirty-per-cent maximum limitation. These same organizations are now included in the definition of "public charities" under the new provisions;⁸ in addition, three new types of foundations⁹ have been included.

² 83 Stat. 487 (1969).

³ 1969 *Hearings* at 5048.

⁴ *Id.* at 5510.

⁵ *Id.* Generally the reforms proposed in this area by the Treasury were an increase in the maximum limitation on deductions to increase the incentive for charitable contributions and an elimination of double deductions, especially as a result of gifts of appreciated property.

⁶ INT. REV. CODE of 1954, as amended by Pub. L. No. 91-172 § 201, 83 Stat. 487 (1969), § 170(b)(1) [hereinafter INT. REV. CODE of 1954 (as amended 1969)]. For a definition of "charitable contribution" see *id.* § 170(c).

⁷ *Id.* § 170(b)(1)(F).

⁸ *Id.* § 170(b)(1)(A).

⁹ *Id.* at (vii) states that "a private foundation described in subparagraph (E)" is included in the definition of "public charities." Subparagraph (E) defines these foundations as (1) private operating foundations, (2) private non-operating foundations that distribute the contributions that they receive to public charities or make other qualifying distributions within two-and-one-half months after their taxable year's end, and (3) community foundations that pool all contributions into a common fund and allow the contributor to designate the charity

As under the old law, deductions for contributions to qualifying organizations not included in the definition of "public charities" are restricted to a maximum of twenty per cent of the contribution base.¹⁰ Furthermore, deductions for such gifts can be taken into account only after deductions for gifts to "public charities" which qualify for the maximum fifty-per-cent limitation.¹¹ Thus, the effect of these provisions is that deductions for gifts made to non-public charities cannot exceed twenty per cent of the contribution base *or* the difference between the total amount of contributions made to public charities and fifty per cent of the contribution base, whichever amount is less.¹² For example, if the contribution base were 100,000 dollars, gifts to public charities were 40,000 dollars, and gifts to non-public charities were 20,000 dollars, only 10,000 dollars of this latter amount would be deductible.

Under the new law, a taxpayer is still allowed to carry over to the next five succeeding years any "excess"¹³ contribution made to public charities; but he may do so only to the extent that the maximum allowable deduction is not used in the year to which the carryover is made.¹⁴ For example, if a taxpayer had a contribution base of 100,000 dollars in each of five successive years and if, in the first year, he gave 100,000 dollars to a public charity, he could deduct 50,000 dollars in that year. If, in the second year, he gave 30,000 dollars to a public charity, he could deduct this additional gift plus 20,000 dollars of the excess 50,000 dollars from the previous year. If, in the third year, he gave 20,000 dollars

that is the recipient. (The income from the common pool must be distributed within two-and-one-half months after the taxable year in which it was realized, and the corpus attributable to any donor's contribution must be distributed to a charity not later than one year after the donor's death or after his surviving spouse's death if she has the right to designate the recipients of the corpus.)

¹⁰ (B) OTHER CONTRIBUTIONS.—Any charitable contribution other than a charitable contribution to which subparagraph (A) applies shall be allowed to the extent that the aggregate of such contributions does not exceed the lesser of—

(i) 20 percent of the taxpayer's contribution base for the taxable year, or

(ii) the excess of 50 percent of the taxpayer's contribution base for the taxable year over the amount of charitable contributions allowable under subparagraph (A) (determined without regard to subparagraph (D)).

Id. § 170(b)(1)(B).

¹¹ *Id.*

¹² See CCH 1970 STAND. FED. TAX REP. ¶ 1271 (4th Extra Ed. No. 3).

¹³ The term "excess" contributions refers to the amount of contributions made by a taxpayer in one taxable year that exceeds the maximum allowable deduction for that year.

¹⁴ INT. REV. CODE of 1954 (as amended 1969), § 170(d)(1).

to a public charity, he could deduct this gift plus the remaining excess of 30,000 dollars from the first year. Thus, in three years he would be able to obtain a full deduction for the gift of 100,000 dollars made in the first year. In the case of excess contributions, when the recipients are non-public charities that are subject to the twenty-per-cent limitation, the rule under the old law continues to apply: no carryover of excess contributions is allowed.¹⁵

Although it did not apply to many taxpayers, there was a special provision in the old law,¹⁶ often referred to as the "Philadelphia-nun" provision, whereby a taxpayer's charitable contributions could qualify for an unlimited deduction if certain requirements were met. New provisions¹⁷ will result in the elimination of this unlimited deduction by 1975. At that time the maximum allowable deduction for gifts to charities will be fifty per cent of the taxpayer's contribution base even though the old "Philadelphia-nun" requirements are met. The phasing out of the unlimited deduction will take place gradually over a five-year period, with an eighty-per-cent maximum deduction allowed in 1970. There will be an annual decrease of six per cent thereafter until 1975.¹⁸

In contrast to the Act's liberalizing effect on the percentage limitations, the new provisions of section 170(f)¹⁹ reduce the allowable deduction for gifts of income and remainder interests in trusts,²⁰ and no deduction is allowed for gifts made for less than the entire interest in the property given.²¹ Thus a deduction is no longer allowed for the rent-free use of property by a charity.²² An exception to this provision is made for gifts of a remainder interest in a personal residence or farm.²³ While such gifts are still deductible, they are subject to special valuation provisions.²⁴

The provisions of the Act that probably will have the greatest limiting effect and also cause the most confusion are those dealing with contribu-

¹⁵ *Id.*

¹⁶ INT. REV. CODE of 1954, § 170(b)(1)(C). This section was completely changed by the 1969 Act.

¹⁷ INT. REV. CODE of 1954 (as amended 1969), § 170(b)(1)(C).

¹⁸ *Id.* § 170(f)(6).

¹⁹ *Id.* § 170(f).

²⁰ *Id.* at (f)(2).

²¹ *Id.* at (f)(3). This section applies to all charitable gifts made after July 31, 1969.

²² *Id.* The Act does not, however, require the taxpayer to include the rental value of the property in his income.

²³ *Id.* § 170(f)(3)(B)(i). See CCH 1970 STAND. FED. TAX REP. ¶ 1281 (4th Extra Ed. No. 3); P-H 1970 FED. TAXES ¶ 114 (Rep. Bull. 1, 1970).

²⁴ INT. REV. CODE of 1954 (as amended 1969), § 170(f)(4).

tions of appreciated property.²⁵ Under the old rules, the deduction for such gifts was generally measured by the fair market value of the property given.²⁶ This method for determining the amount of the deduction often made it possible for the taxpayer to realize a greater tax advantage from a gift of appreciated property than he could have obtained from a cash contribution because it allowed a deduction for income or gain that had not been recognized for tax purposes. For example, if a taxpayer donated to a public charity stock that had cost him 5,000 dollars but that had a fair market value of 10,000 dollars, he would be allowed a charitable deduction of 10,000 dollars without having to treat the gain of 5,000 dollars as income or capital gain for tax purposes. If he sold the stock and donated the proceeds, he would still have received a deduction of 10,000 dollars; but he would have had to recognize a capital gain of 5,000 dollars for tax purposes. The 1969 Act is aimed at equalizing the consequences of cash gifts and gifts of appreciated property by eliminating the double tax benefit of the latter, but it is doubtful that the new law will have such an effect.

As discussed above, the Act generally provides that contributions to public charities may be deducted to the extent that the aggregate of such gifts does not exceed fifty per cent of the taxpayer's contribution base for the taxable year. Deductions for contributions of "capital gain property" and "ordinary income property," however, are now subject to special limitations.²⁷ For purposes of the section of the Act dealing with charitable deductions, "capital gain property" is defined as any capital asset on which a long-term capital gain would have been realized if the taxpayer had sold the asset for its fair market value on the date of the contribution.²⁸ As a consequence of these new special-limitation rules, if a taxpayer donates "capital gain property" to a public charity, he is still able to claim a deduction for the full fair market value; and he is not subject to any capital gains tax on his paper profit.²⁹ The aggregate of such deductions, however, is limited to a maximum of thirty per cent of his contribution base rather than to the fifty-per-cent maximum that applies to gifts of cash or non-appreciated property. Furthermore, the

²⁵ *Id.* §§ 170(b)(1)(D), 170(e)(1).

²⁶ Treas. Reg. § 1.170-1(c) (1958).

²⁷ INT. REV. CODE of 1954 (as amended 1969), §§ 170(b)(1)(D), 170(e)(1).

²⁸ *Id.* § 170(b)(1)(D)(iv). For a definition of "ordinary income property" see p. 977 *infra*.

²⁹ "Paper profit" refers to the inherent gain that would be recognized for tax purposes and would represent long-term capital gain had the property been sold instead of having been given to charity.

deductions for gifts of "capital gain property" are computed after all other contributions are taken into consideration.³⁰ For example, a taxpayer may have a contribution base of 10,000 dollars and give 4,000 dollars in cash and 2,000 dollars in appreciated stocks to a public charity. Since his maximum deduction is 5,000 dollars (50 per cent of 10,000 dollars) and since the cash gift must be considered first, the deduction for the gift of stock is limited to 1,000 dollars in the current taxable year. Gifts of "capital gain property," however, may be carried over for up to five years, but they retain their original status and are deductible in any one taxable year only to a maximum of thirty per cent of the donor's contribution base.³¹

There are two situations in which the thirty-per-cent limitation does not apply to contributions of "capital gain property." If such property is given to a "non-public" charity³² or if *tangible* personal property is given to a public charity for purposes other than for use in its principal charitable function,³³ a special provision takes effect.³⁴ Under this provision, the allowable deduction is the fair market value of the gift reduced by one half of the amount of the gain that would have been recognized if the property had been sold by the taxpayer at its fair market value on the date of the contribution. The deductions under this special provision are also subject to the appropriate maximum limitations—fifty per cent of the contribution base for gifts of tangible personal property to a "public charity"³⁵ and twenty per cent when the donee is a "non-public" charity.³⁶

Furthermore, the Conference Committee Report states that when a taxpayer "makes a contribution to a public charity of [capital gain] property . . . the taxpayer may deduct such contributions of property under

³⁰ INT. REV. CODE of 1954 (as amended 1969), § 170(b)(1)(D)(i) provides:

In the case of charitable contributions of capital gain property to which subsection (e)(1)(B) does not apply, the total amount of contributions of such property which may be taken into account under subsection (a) for any taxable year shall not exceed 30 percent of the taxpayer's contribution base for such year. For purposes of this subsection, contributions of capital gain property to which this paragraph applies shall be taken into account after all other charitable contributions.

³¹ *Id.* § 170(b)(1)(D)(ii). See text preceding note 14 *supra*.

³² *Id.* § 170(e)(1)(B)(ii).

³³ *Id.* § 170(e)(1)(B)(i). Intangible personal property is not included under this provision as is erroneously stated in CCH 1970 STAND. FED. TAX REP. ¶ 1277 (4th Extra Ed. No. 3). This error was corrected *id.* [Green ¶ 1854-56] at 21,997.

³⁴ INT. REV. CODE of 1954 (as amended 1969), § 170(e)(1).

³⁵ *Id.* § 170(b)(1)(A).

³⁶ See note 10 *supra*.

the 50 per cent limitation if he *elects to take the unrealized appreciation into account for tax purposes.*³⁷ This does not mean, however, that the gain must be recognized and capital gains tax paid on it. Presumably, to "take . . . into account for tax purposes" means that the deduction is limited according to the provisions of subsection 170(e)(1).³⁸ While the precise manner and time of making the election must await delineation by the Treasury, it is clear that the function of subsection 170(b)(1)(D)(iii)³⁹ is to provide such an election. If the taxpayer does elect under subsection (b)(1)(D)(iii) to "take the unrealized appreciation into account for tax purposes" in accordance with subsection (e)(1), a deduction qualifying for the fifty-per-cent limitation is allowed in the amount of the fair market value of the property reduced by one half of the gain that would have been realized if the property had been sold for its fair market value on the date of the contribution.⁴⁰ Thus, under this provision, if a gift of stock (which had been held for six months or more) with a basis of 100 dollars and a fair market value of 200 dollars was given to a "public charity," the allowable deduction would be 150 dollars; and this total amount would qualify for the maximum limitation of fifty per cent of the taxpayer's contribution base.⁴¹ And election to "take the unrealized appreciation into account" is probably to the taxpayer's advantage if the appreciation is nominal or if a large immediate deduction is needed.⁴²

³⁷ H.R. REP. NO. 91-782, 91st Cong., 1st Sess. 292 (1969) (emphasis added).

³⁸ See note 39 *infra*.

³⁹ (iii) At the election of the taxpayer (made at such time and in such manner as the Secretary or his delegate prescribes by regulations), subsection (e)(1) shall apply to all contributions of capital gain property (to which subsection (e)(1)(B) does not otherwise apply) made by the taxpayer during the taxable year. If such an election is made, clauses (i) [which limits deductions of capital gain property to 30 percent] and (ii) [which permits a carryover of such gifts] shall not apply to contributions of capital gain property made during the taxable year

INT. REV. CODE OF 1954 (as amended 1969), § 170(b)(1)(D)(iii).

⁴⁰ (1) GENERAL RULE.—The amount of any charitable contribution of property otherwise taken into account under this section [in this case by the election under (b)(1)(D)(iii)] shall be reduced by . . . 50 percent . . . of the amount of gain which would have been long-term capital gain if the property contributed had been sold by the taxpayer at its fair market price (determined at the time of such contribution).

Id. § 170(e)(1).

⁴¹ In applying the fifty-per-cent carryover for any year in which this selection is made, the taxpayer must remember that contributions of "capital gain property" in any prior year for which an election was not made must be reduced as if they were subject to the reduced-contribution rule when they were made. See INT. REV. CODE OF 1954 (as amended 1969), § 170(b)(1)(D)(iii).

⁴² 33 & 34 AM. JUR. *Federal Taxation* 63 (Special Supp. 1970).

In the case of contributions of "ordinary income property," the new Act imposes the most stringent restrictions of all. While the maximum fifty-per-cent limitation applies, the provision applicable to such gifts states that "the amount of any charitable contribution of property . . . shall be reduced by . . . the amount of gain which would not have been long-term capital gain if the property contributed had been sold by the taxpayer at its fair market value."⁴³ This provision thus permits a deduction for gifts of "ordinary income property" only to the extent of the taxpayer's basis in the property. "Ordinary income property" is not specifically defined in the Act; but it is clear that the term applies to any property that, if sold by the taxpayer on the date of the contribution at its fair market value, would have resulted in ordinary income to him. The Senate and House Committee Reports⁴⁴ indicate that "ordinary income property" includes inventory; "section 306 stock,"⁴⁵ works of art, books, letters, and memorandums that are given by the person who created them; and stock held for less than six months.

Since "inventory" is included in this definition and since contributions of inventory are deductible only to the extent of basis, the question arises whether Revenue Rulings 55-138⁴⁶ and 55-531,⁴⁷ as embodied in subsection 1.170-1(c) of the Treasury Regulations,⁴⁸ still apply. These rulings hold, in effect, that when inventory is given, the cost of the property, or its inventory value, must be eliminated from the taxpayer's beginning inventory account. There does not seem to be any inconsistency between the new Act and these two rulings, and there appears to be no reason why they should not still apply. Thus, a taxpayer will be limited, under the Act, to the amount of his basis when he claims a deduction for a gift of inventory; and, under the Treasury's rulings, he will still have to remove the value of the property given to charity from his beginning inventory account. If the law was otherwise, he would receive a double tax benefit because he would be allowed a charitable deduction for an item that, in effect, would have cost him nothing.⁴⁹

⁴³ INT. REV. CODE of 1954 (as amended 1969), § 170(e)(1)(A).

⁴⁴ S. REP. No. 91-552, 91st Cong., 1st Sess. 81 (1969); H.R. REP. No. 91-413 (Part 1), 91st Cong., 1st Sess. 55 (1969).

⁴⁵ For a definition of "Section 306 stock," see INT. REV. CODE of 1954 (as amended 1969), § 306(c); see generally B. BITTKER & J. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS § 8.03 (2d ed. 1966).

⁴⁶ Rev. Rul. 55-138, 1955-1 CUM. BULL. 223.

⁴⁷ Rev. Rul. 55-531, 1955-2 CUM. BULL. 520.

⁴⁸ Treas. Reg. § 1.170-1(c) (1958).

⁴⁹ If the regulation did not require that the value of the donated inventory item be removed from the beginning inventory account, the result would be an inflated

It should be noted that the definition of "ordinary income property" includes that portion of a gift of *depreciable* real or tangible personal property used in a taxpayer's trade or business that would have been subject to the depreciation recapture rules⁵⁰ if the property had been sold at its fair market value at the date of contribution. Any gain above this amount is treated as "capital gain property" and is subject to the provisions of the Act applicable to such property.⁵¹

In addition to the provisions discussed above regarding gifts to charitable organizations, the 1969 Act also provides specifically for the adjustment of basis in bargain sales to charitable organizations.⁵² Under the old law, if a taxpayer sold property with a basis of 12,000 dollars and a fair market value of 20,000 dollars to a charity for the amount of his basis, he recognized no gain and was allowed a charitable deduction of 8,000 dollars. If he had sold the property to the charity for 14,000 dollars, he would have had a 2,000 dollars gain, which would have been recognized for tax purposes, and a charitable deduction of 6,000 dollars. In other words, all of his basis was offset against the proceeds of the sale to determine his gain, and the amount of the fair market value of the property in excess of the proceeds from the sale was treated as a charitable contribution. Under the new law, the basis must be allocated between the portion "sold" and the portion "given" to the charity.⁵³ In the first of the two examples immediately above, the taxpayer would, under the Act, be required to allocate sixty per cent of his basis (7,200 dollars) to the portion "sold" and forty per cent (4,800 dollars) to the portion "given" to the charity. Thus, the taxpayer would be required to include 4,800 dollars (12,000 dollars [total basis] — 7,200 dollars [basis allocated to portion "sold"] = 4,800 dollars) as a gain from the sale of a capital asset in his tax return; and, as under prior law, he would be allowed a

cost-of-goods-sold figure that would reduce the net profit on which income tax is computed.

⁵⁰ See INT. REV. CODE OF 1954 (as amended 1969), §§ 617(d)(1) (mining property), 1245(a), 1250(a), 1251(c), 1252(a).

⁵¹ *Id.* § 170(e)(1). See 2 CCH 1970 STAND. FED. TAX REP [Green ¶ 1854-56] at 21,998; P-H 1970 FED. TAXES ¶ 113 (Rep. Bull. 1, 1970).

⁵² (b) BARGAIN SALE TO A CHARITABLE ORGANIZATION.—If a deduction is allowable under section 170 (relating to charitable contributions) by reason of a sale, then the adjusted basis for determining the gain from such sale shall be that portion of the adjusted basis which bears the same ratio to the adjusted basis as the amount realized bears to the fair market value of the property.

INT. REV. CODE OF 1954 (as amended 1969), § 1011(b). This section applies to all such sales made after December 19, 1969.

⁵³ See H.R. REP. NO. 91-413 (Part 1), 91st Cong., 1st Sess. 55-56 (1969).

deduction of 8,000 dollars.⁵⁴ Furthermore, since this contribution is one of appreciated property, it would appear that all of the rules applicable to such contributions must be considered.⁵⁵

An overall view of the provisions of the 1969 Act relating to charitable deductions seems to indicate that the new law will have little economic effect on the individual taxpayer. It is doubtful that the increase in the maximum limitation will be a greater incentive for charitable contributions since very few individuals contribute the maximum deductible amount to charity each year. Furthermore, because of the five-year carry-over provisions, which also applied under the old law, most taxpayers could deduct the entire amount of their charitable contributions anyway. While the new provisions eliminate most of the tax advantages previously available for taxpayers making charitable contributions of "ordinary income property," many of the double tax savings still remain for gifts of "capital gain property." Thus, even though many of the rules governing charitable deductions have been tightened, the individual taxpayer, by carefully following the new rules discussed in this note, can still enjoy significant tax benefits through the use of charitable contributions.

TURNER VANN ADAMS

Income Tax—Problems of a Corporate Executor in the Administration of Successive Estates

The gain or loss from the sale or exchange of property is determined, for tax purposes, by the relation of the "amount realized" to the adjusted basis of the property.¹ The method used to compute the basis for the capital gains of property acquired from a decedent is defined by section 1014 of the Internal Revenue Code of 1954 to be "the fair market value of the property at the date of the decedent's death . . ."² In *Manufacturers Hanover Trust Co. v. United States*³ the United States Court of Claims applied section 1014 in a case involving successive deaths.

The plaintiff, a corporate executor, brought an action for refund of federal income taxes paid by the estate. The plaintiff was the executor of

⁵⁴ *Id.*

⁵⁵ P.H. 1970 FED. TAXES ¶ 115 (Rep. Bull. 1, 1970).

¹ INT. REV. CODE of 1954, § 1001.

² *Id.* § 1014(a).

³ 410 F.2d 767 (Ct. Cl. 1969).