

Taxpayers will find it helpful to read General Instructions A to M before commencing to fill in their returns, and to read Specific Instructions in connection with filling in the items to which they refer. (References are to the Revenue Act of 1938, unless otherwise noted.)

GENERAL INSTRUCTIONS

A. WHO MUST MAKE A RETURN.—For each taxable year a return of income shall be made by every citizen of the United States, whether residing at home or abroad, and every individual residing within the United States though not a citizen thereof, whether or not he is the head of a family or has dependents—

1. If single or married and not living with husband or wife for any part of the taxable year, and if—

(a) having for the taxable year a gross income (as defined in sections 22 and 116) of \$5,000 or over; or

(b) having for the taxable year a net income (as defined in section 21) of \$1,000 or over.

2. If married and living with husband or wife for the entire taxable year, if no joint return is made, and if—

(a) having for the taxable year a net income of \$2,500 or over or a gross income of \$5,000 or over (regardless of the amount of the net income), and the other spouse has no gross income; or

(b) such individual and his or her spouse each has for the taxable year a gross income (regardless of the amount of the net income) and the aggregate net income of the two is \$2,500 or over; or

(c) such individual and his or her spouse each has for the taxable year a gross income (regardless of the amount of the net income) and the aggregate gross income is \$5,000 or over.

3. If married and living with husband or wife for any part of the taxable year, but not at the close thereof, or if married and living with husband or wife at the close of the taxable year, but not during the entire taxable year, if no joint return is made, and if—

(a) having for the taxable year a net income equal to, or in excess of, the credit allowed him or her by section 25 (b) (1) and (3) (computed without regard to any credit to which he or she may be entitled as the head of a family (see Specific Instructions 22 and 23)), or a gross income of \$5,000 or over (regardless of the amount of the net income) and the other spouse has no gross income; or

(b) such individual and his or her spouse each has for the taxable year a gross income (regardless of the amount of the net income), and the aggregate net income of the two is equal to, or in excess of, the credit allowed them by section 25 (b) (1) and (3) (computed without regard to any credit to which either or both may be entitled as the head of a family (see Specific Instructions 22 and 23)); or

(c) such individual and his or her spouse each has for the taxable year a gross income (regardless of the amount of the net income), and their aggregate gross income is \$5,000 or over.

4. A husband and wife, if living together at the close of the taxable year, may elect to make a joint return, that is, to include in a single return made by them jointly the income and deductions of each, even though one has no gross income. In such a case, the tax shall be computed on the aggregate income and all deductions and credits to which either is entitled shall be taken from such aggregate income. The liability with respect to the tax shall be joint and several. If one spouse dies prior to the last day of the taxable year, the surviving spouse may not include the income of the deceased spouse in a joint return for such taxable year. A joint return may not be made if either the husband or wife is a nonresident alien.

B. WHO MUST USE FORM 1040.—Form 1040 must be used by all individuals (except nonresident aliens), who are required to make returns and (1) whose net income is more than \$5,000, or (2) whose income, regardless of amount, includes any item other than salaries or other compensation received from others for personal services, dividends, interest, and taxable income from annuities, or (3) whose return is made on an accrual basis, or (4) whose return is made for a fiscal year.

All other individuals, except nonresident aliens, required to make returns shall use Form 1040A. Nonresident aliens are required to use Form 1040B or Form 1040NB.

C. RETURNS OF INCOME OF DECEDENTS.—If the net income of a decedent to the date of his death was \$1,000 or over, if unmarried, or equal to or in excess of the credit allowed him by section 25 (b) (1) and (3) (computed without regard to his status as the head of a family), if married and living with spouse, or if his gross income for the period was \$5,000 or over, the executor or administrator shall make a return for him on Form 1040 or Form 1040A. The return for a decedent shall include all items of income and deductions accrued up to the date of death (except deductions under section 23(o)) regardless of the fact that the decedent may have kept his books on a cash basis or kept no books.

Returns of income of estates and trusts must be made on Form 1041.

D. PERIOD TO BE COVERED BY RETURN.—Calendar year 1938 or fiscal year beginning in 1938 and ended in 1939.

The established accounting period must be adhered to for all years, unless permission is received from the Commissioner to make a change. An application for a change in the accounting period shall be made on Form 1128 and forwarded to the collector prior to the expiration of 30 days from the close of the proposed taxable year.

E. WHEN AND WHERE THE RETURN MUST BE FILED.—On or before the 15th day of the third month following the close of your taxable year with the collector of internal revenue for the district in which you live or have your principal place of business. In case you have no legal residence or place of business in the United States, the return should be forwarded to Collector of Internal Revenue, Baltimore, Md.

Your home or residential address should be given in the space provided at the top of the first page of the return. If you have a permanent business address, that address may be given as the principal or mailing address, provided that the complete home or residential address is also given.

F. AFFIDAVITS.—The affidavit must be executed by the person whose income is reported or by his legal representative or agent. The return may be made by an agent (1) if, by reason of illness, the person liable for the making of the return is unable to make it, or (2) if the taxpayer is unable to make the return by reason of continuous absence from the United States for a period of at least 60 days prior to the date prescribed by law for making the return. Whenever a return is made by an agent, it must be accompanied by a power of attorney on Form 935, or, in the case of husband and wife, on Form 936 (copies of which may be obtained from any collector of internal revenue).

Where the return is actually prepared by some person or persons other than the taxpayer, such person or persons must execute the affidavit at the foot of page 4 of the return.

The oath or affirmation will be administered without charge by any collector, deputy collector, or internal revenue agent. If an internal revenue officer is not available, the return should be sworn to before a person authorized to administer oaths for general purposes by the law of the United States or of any State, Territory, or possession of the United States, or of the District of Columbia, wherein such oath or affirmation is administered, except an attorney or agent employed to represent the taxpayer before the Department in connection with his tax liability.

G. WHEN AND TO WHOM THE TAX MUST BE PAID.—The tax may be paid by sending or bringing with the return a check or money order drawn to the order of "Collector of Internal Revenue." Do not send cash by mail, nor pay it in person except at the collector's office.

The tax must be paid in full when the return is filed, or in four equal installments, as follows: On or before the 15th day of the third month, on or before the 15th day of the sixth month, on or before the 15th day of the ninth month, and on or before the 15th day of the twelfth month, from the close of the taxable year. If any installment is not paid on or before the date fixed for payment, the whole amount of tax unpaid shall be paid upon notice and demand by the collector.

H. PENALTIES.—The law imposes severe penalties for failing to make a return or for making a false or fraudulent return. Penalties are also imposed for failing to file a return on time.

I. RECEIVED OR ACCRUED INCOME.—If your books of account are kept on the accrual basis, report all income accrued, even though it has not been actually received or entered on the books, and expenses incurred instead of expenses paid. As to items not deductible consisting of unpaid expenses and interest due to certain persons, see Specific Instruction 14. If your books are not kept on the accrual basis, or if you kept no books, make your return on a cash basis and report all income received or constructively received, such as bank interest credited to your account and coupon bond interest matured, and report expenses actually paid.

J. ITEMS PARTIALLY AND WHOLLY EXEMPT FROM TAX.—All items of income received and claimed to be wholly exempt should be explained in Schedule I, except interest to be reported in Schedule B.

1. The following items are *partially* exempt from tax:

(a) Amounts received (other than amounts paid by reason of the death of the insured, and interest payments on such amounts and other than amounts received as annuities) under a life insurance or endowment contract, but if such amounts (when added to amounts received before the taxable year under such contract) exceed the aggregate premiums or consideration paid (whether or not paid during the taxable year) then the excess shall be included in gross income;

(b) The interest on United States Savings Bonds and Treasury Bonds, owned in excess of \$5,000, and interest on obligations of instrumentalities of the United States (other than obligations issued under the Federal Farm Loan Act or under such Act as amended) is subject to surtax if the surtax net income is over \$4,000. Such interest should be reported in Schedule B (see also Specific Instruction 5); and

(c) Dividends on share accounts in Federal savings and loan associations, but such dividends are subject to surtax if the surtax net income is over \$4,000 (see Specific Instruction 11).

2. The following items are *wholly* exempt from tax:

(a) Amounts received under a life insurance contract paid by reason of the death of the insured; whether in a single sum or in installments (but if such amounts are held by the insurer under an agreement to pay interest thereon, the interest payments shall be included in gross income);

(b) Gifts (not received as a consideration for service rendered) and money and property acquired by bequest, devise, or inheritance (but the income derived from such property is taxable and must be reported);

(c) Amounts received through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness, plus the amount of any damages received, whether by suit or agreement, on account of such injuries or sickness;

(d) The rental value of a dwelling house and appurtenances thereof furnished to a minister of the gospel as part of his compensation;

(e) Compensation paid by a State or political subdivision thereof to its officers or employees for services rendered if such compensation is constitutionally exempt from Federal taxation;

(f) Pensions and compensation received by veterans from the United States and pensions received from the United States by the family of a veteran, for services rendered by the veteran to the United States in time of war;

(g) Amounts received as earned income from sources without the United States (except amounts paid by the United States or any agency thereof) by an individual citizen of the United States who is a bona fide nonresident for more than 6 months during the taxable year (the taxpayer in such a case may not deduct from his gross income any amount properly allocable to or chargeable against the amount so excluded from his gross income); and

(h) The interest on (1) obligations of a State, Territory, or political subdivision thereof, or the District of Columbia, or United States possessions; (2) obligations issued under Federal Farm Loan Act, or under such Act as amended; (3) obligations of United States issued on or before September 1, 1917; and (4) Treasury Notes, Treasury Bills, and Treasury Certificates of Indebtedness.

K. TREATMENT OF DEPRECIATION AND DEPLETION.—A reasonable allowance for the exhaustion, wear and tear, including obsolescence, of property used in the trade or business may be deducted. All deductions for depreciation must be explained in Schedule E. If obsolescence is claimed, explain why the useful life is less than the actual life.

The amount of depreciation on property acquired by purchase should be determined upon the basis of the original cost (not replacement cost) of the property and the probable number of years, remaining of its expected useful life, except if the property was purchased prior to March 1, 1913, it will

be computed on the fair market value of such property as of that date or its original cost (less depreciation actually sustained before that date), whichever is greater. If the property was acquired in any other manner than by purchase, see section 114.

See sections 23 (m) and 114 and Regulations 101 with respect to additional forms and information required if a deduction is claimed for depletion.

L. INFORMATION AT SOURCE.—Every person making payments of salaries, wages, interest, rents, commissions, or other fixed or determinable income of \$1,000 or more during the calendar year 1938, to an individual, a partnership, or a fiduciary, is required to make a return on Forms 1096 and 1099 showing the amount of such payments and the name and address of each recipient, except that a return need not be made for payments of salaries or other compensation for personal services aggregating less than \$2,500 made to a married individual. These forms will be furnished by any collector of internal revenue upon request and must be forwarded to the

Commissioner of Internal Revenue Sorting Section, Washington, D. C., in time to be received not later than February 15, 1939.

M. STOCK OWNED IN FOREIGN CORPORATIONS AND PERSONAL HOLDING COMPANIES.—If at any time during the taxable year you owned directly or indirectly any stock of a foreign corporation (including a foreign personal holding company, as defined in section 331, in which you owned less than 5 percent in value of the outstanding stock of such company) or a personal holding company, as defined by section 402, attach to your return a statement setting forth the name and address of each such company and the total number of shares of each class of outstanding stock owned by you during the taxable year. If you owned stock at any time during the taxable year in a foreign personal holding company, as defined in section 331, you must include in your return as a dividend the amount required to be included in your gross income by section 337. If you owned 5 percent or more in value of the outstanding stock of such foreign personal holding company, set forth in an attached statement in complete detail the information required by section 337 (d).

SPECIFIC INSTRUCTIONS

The following instructions are numbered to correspond with item numbers on page 1 of the return:

1. Salaries and other compensation for personal services.—Any amount claimed as a deduction for ordinary and necessary expenses against salaries, etc., such as traveling expenses while away from home in connection with your occupation, should be fully explained in Schedule A or in an attached statement. Traveling expenses ordinarily include expenditures for transportation, meals, and lodging. The expenses of a commuter in traveling to and from work are not deductible.

If a joint return is filed, enter as separate items in Schedule A earnings of each spouse. Earnings of minor children should also be entered in Schedule A, if parent is legally entitled to such earnings.

2. Dividends.—Enter as item 2 the total of all taxable dividends received from domestic and foreign corporations. Enter in Schedule I all dividends received which are claimed to be nontaxable, and include in item 11 dividends on share accounts in Federal savings and loan associations.

5. Interest on Government obligations, etc.—Interest on an aggregate of not exceeding \$5,000 principal amount of the obligations enumerated on line (e), Schedule B, is exempt from the surtaxes imposed by section 12. Enter in column 4, line (e), interest received from such obligations in an amount not exceeding the interest received or accrued on an aggregate principal of \$5,000 of such obligations. If at any time during the taxable year you held more than \$5,000 principal in the aggregate of such obligations, enter in column 5, line (e), the interest received or accrued in excess of interest on an aggregate of \$5,000 principal amount of such obligations. If, during the taxable year, you were the beneficiary of an estate or trust, the income of which is to be distributed to the beneficiaries currently, or a member of a partnership, you are entitled to exemption as if you owned directly a proportionate part of such obligations. Therefore, your proportionate part should be included in filling out Schedule B.

Interest coupons falling due within the taxable year will be considered as income for such year where the books are kept on a cash basis. If the books are kept on an accrual basis, report the actual amount of interest accrued on the obligations owned during the taxable year.

6, 7. Income from partnerships, syndicates, pools, etc., and fiduciaries.—Enter as item 6 your share of the profits (whether received or not) or of the losses of a partnership (including a syndicate, pool, etc., not taxable as a corporation) except your distributive share of partnership capital gains or losses, which should be reported in Schedule F and included in item 10 (a) or (b). Enter as item 7 income from an estate or trust. Your share of interest on obligations of the United States, etc., owned by a partnership or an estate or trust should be included in Schedule B. (See also Specific Instruction 5.) Include in items 32 and 33, respectively, your share of credits claimed for Federal income tax paid at source and foreign income and profits taxes.

If the taxable year on the basis of which you file your return does not coincide with the annual accounting period of the partnership or fiduciary, you should include in your return your distributive share of the net profits for such accounting period ending within or with your taxable year.

If the taxable year of the partnership began before January 1, 1938, and your taxable year began after December 31, 1937, see section 188 (b).

8. Income from rents and royalties.—Fill in Schedule C giving the information requested.

If you received property or crops in lieu of cash rents, report the income as though the rent had been received in cash. Crops received as rent on a crop-share basis should be reported as income for the year in which disposed of (unless your return is on the accrual basis).

9. Profit (or loss) from business or profession.—If you owned a business, or practiced a profession on your own account, fill in Schedule D of the return, and enter the net profit (or loss) as item 9 of the return.

Farmer's income schedule.—If you are a farmer and keep no books of account, or keep books on a cash basis, obtain from the collector, and attach to this return, Form 1040F, Schedule of Farm Income and Expenses, and enter the net farm income as item 9 of the return. If your farm books of account are kept on an accrual basis, the filing of Form 1040F is optional.

Installment sales.—If the installment method is used, attach to the return a schedule showing separately for the years 1935, 1936, 1937, and 1938

the following: (a) Gross sales; (b) cost of goods sold; (c) gross profits; (d) percentage of profits to gross sales; (e) amount collected; and (f) gross profit on amount collected. (See section 44.)

Inventories.—If you are engaged in a trade or business in which the production, manufacture, purchase and sale of merchandise is an income-producing factor, inventories of merchandise on hand should be taken at the beginning and end of the taxable year, which may be valued at (a) cost, or (b) cost or market, whichever is lower. Taxpayers were given an option to adopt the basis of either (a) cost, or (b) cost or market, whichever is lower, for their 1920 inventories. The basis properly adopted for that year or any subsequent year is controlling and a change can now be made only after permission is secured from the Commissioner. Application for permission to change the basis of valuing inventories shall be made in writing and filed with the Commissioner within 90 days after the beginning of the taxable year in which it is desired to make the change. With respect to inventories of producers and processors of certain nonferrous metals and tanners, see section 22 (d).

Salaries.—Do not include compensation for services of yourself, your dependent minor children (if you are legally entitled to their earnings) or of husband or wife if a joint return is filed, which items are not deductible.

Interest.—Enter on line 11 interest on business indebtedness. Do not include interest to yourself on capital invested in or advanced to the business. As to limitations on deductions for unpaid expenses and interest to certain persons, see Specific Instruction 14.

Taxes.—Enter on line 12 taxes on business property or for carrying on business. (See Specific Instruction 15.)

Losses.—Enter on line 13 losses incurred in the trade or business, if not compensated for by insurance or otherwise. (See also Specific Instruction 16.) Losses from sale or exchange of capital assets and other property should be entered in Schedules F and G, respectively, and item 10 of the return.

Bad debts.—Bad debts may be treated in either of two ways—(1) by a deduction from income in respect of debts ascertained to be worthless in whole or in part, or (2) by a deduction from income of a reasonable addition to a reserve for bad debts.

Taxpayers were given an option for 1921 to select either of these methods and the method used in the return for the year 1921 must be used in returns for all subsequent years unless permission is granted by the Commissioner to change to the other method. Application for permission to change the method shall be made in writing at least 30 days prior to the close of the taxable year for which it is desired to effect the change.

A taxpayer filing a first return of income may select either of the two methods mentioned above subject to approval by the Commissioner upon examination of the return. If the method selected is approved, it must be followed in returns for subsequent years, except as permission may be granted by the Commissioner to change to the other method.

If the reserve method is used, you should attach to your return the statement required by article 23 (k)–5 of Regulations 101.

Debts arising from sales or services are not deductible unless the original amount has been reported as income. Bonds which are ascertained to be worthless and charged off within the taxable year, and which are capital assets, are not to be treated as bad debts, but the loss resulting therefrom shall be considered as a loss from the sale or exchange, on the last day of such taxable year, of capital assets and should be reported in Schedule F.

A debt previously charged off, allowed as a deduction, and subsequently collected must be returned as income for the year in which collected.

Rents, repairs, and other expenses.—Do not include rent for a dwelling occupied by you for residential purposes, the cost of business equipment or furniture, expenditures for replacements or permanent improvements to property, nor personal, living, or family expenses.

10. Gains and losses from sales or exchanges of capital assets and other property.—Report sales or exchanges of capital assets in Schedule F, and sales or exchanges of other property in Schedule G, and enter the net amount of gain or loss to be taken into account in computing net income as item 10.

Definition of "capital assets."—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or

business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business at the time of the sale or exchange, of a character which is subject to the allowance for depreciation. The exclusion from the term "capital assets" of property used in the trade or business of a taxpayer of a character which is subject to allowance of depreciation provided in section 23 (l) is limited to property used by the taxpayer in the trade or business at the time of the sale or exchange. It has no application to gains or losses arising from the sale of real property used in the trade or business to the extent that such gain or loss is allocable to the land, as distinguished from depreciable improvements upon the land.

Description of property.—Every sale or exchange of property, even though no gain or loss may be indicated, must be reported in detail. Enter full description of each item of property sold or exchanged. Such description should include the following facts: (a) For real estate, location and description of land, description of improvements, details explaining depreciation (column 7 of Schedule F); (b) for bonds or other evidences of indebtedness, name of issuing corporation, description of the particular issue, denomination, and amount; and (c) for stocks, name of corporation, class of stock, number of shares, capital changes affecting basis (nontaxable stock dividends, other nontaxable dividends, stock rights, etc.).

Basis.—If the property was acquired before March 1, 1913, the "basis" for the property is not subject to the same rule for reporting gains as for losses. In such cases, the basis for determining GAIN is the cost or the fair market value as of March 1, 1913, adjusted as provided in section 113 (b), whichever is greater, but in determining LOSS the basis is cost so adjusted. If the property was acquired after March 1, 1913, basis for both gain and loss is the cost of such property, except as otherwise provided in section 113. The exceptions arise chiefly where property was acquired by gift, bequest, tax-free exchange, involuntary conversion, wash sale of stock; and in such cases section 113 provides the basis that shall be used. If the amount shown as the basis is other than actual cash cost of the property sold or exchanged, full details must be furnished regarding the acquisition of the property.

Enter in column 7 of Schedule F, or in column 6 with respect to Schedule G, the amount of depreciation, exhaustion, wear and tear, obsolescence, or depletion which has been allowed (but not less than the amount allowable) in respect of such property since date of acquisition, or since March 1, 1913, if the property was acquired before that date. In addition, if the property was acquired before March 1, 1913, the cost shall be reduced by the depreciation actually sustained before that date.

Subsequent improvements include expenditures for additions, improvements, and renewals and replacements made to restore the property or prolong its useful life. Do not deduct ordinary repairs, interest, or taxes in computing gain or loss.

Losses on securities becoming worthless.—If any securities (as defined below) are ascertained to be worthless and charged off within the taxable year and are capital assets, the loss resulting therefrom shall, in the case of a taxpayer other than a bank, as defined in section 104, be considered as a loss from the sale or exchange, on the last day of such taxable year, of capital assets.

Definition of securities.—As used for this purpose, the term "securities" means bonds, debentures, notes, or certificates, or other evidences of indebtedness, issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form.

Losses on stocks or stock rights becoming worthless.—If any shares of stock in a corporation or rights to subscribe for or to receive such shares become worthless during the taxable year, and are capital assets, the loss resulting therefrom shall be considered as a loss from the sale or exchange, on the last day of such taxable year, of capital assets.

Classification of capital gains and losses.—Section 117 (a) (2) to (9), inclusive, defines "short-term capital gain," "short-term capital loss," "long-term capital gain," "long-term capital loss," "net short-term capital gain," "net short-term capital loss," "net long-term capital gain," and "net long-term capital loss." The phrase "short-term" applies to the category of gains and losses arising from the sale or exchange of capital assets held for 18 months or less; the phrase "long-term," to the category of gains and losses arising from the sale or exchange of capital assets held for more than 18 months.

In the case of individuals, gains and losses from the sale or exchange of capital assets held for not more than 18 months (described as short-term capital gains and short-term capital losses) shall be segregated from gains and losses arising from the sale or exchange of such assets held for more than 18 months (described as long-term capital gains and long-term capital losses).

Percentage of capital gain or loss taken into account.—In computing the net income of an individual, the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100%	If the capital asset has been held for not more than 18 months;
66⅔%	If the capital asset has been held for more than 18 months and not more than 24 months;
50%	If the capital asset has been held for more than 24 months.

Limitation on short-term capital losses.—Section 117 (d) (2) provides a limitation on deductions for short-term capital losses of individuals, that is, losses from sales or exchanges of capital assets held for 18 months or less

shall be allowed as deductions only to the extent of the gains from sales or exchanges of capital assets held for 18 months or less. However, subsection (e) provides that in the case of an individual having in any taxable year (beginning after December 31, 1937) a net short-term capital loss, he may carry over such loss, in an amount not in excess of his net income for such year (the year in which the loss is realized), to the next succeeding taxable year and treat it in such succeeding year as a short-term capital loss. The carry-over is thus applied in such succeeding year to offset any short-term capital gains in such succeeding year not already offset by short-term capital losses in such year. The carry-over is restricted to one year, namely the succeeding taxable year, and hence the amount of the net short-term capital loss carry-over may not be included in computing a new short-term capital loss which can be carried over to the succeeding taxable year. In the case of individuals, there is no limitation on deductions for long-term capital losses.

Alternative tax in case of net long-term capital gain or loss.—In the case of a net long-term capital gain of an individual, subsection (c) (1) of section 117 imposes an alternative tax in lieu of the normal tax and surtax imposed upon net income, if and only if such alternative tax is less than the tax otherwise imposed. This alternative tax is the sum of (1) a partial tax, computed at the normal tax and surtax rates on the net income of the taxpayer decreased by the amount of such net long-term capital gain, plus (2) 30 percent of the net long-term capital gain.

In the case of a net long-term capital loss of an individual, an alternative tax is imposed in lieu of the normal tax and surtax imposed on net income, if and only if such alternative tax is greater than the tax otherwise imposed. This alternative tax is the excess of (1) a tax, computed at the normal tax and surtax rates on the net income of the taxpayer increased by the amount of such net long-term capital loss, over (2) 30 percent of the net long-term capital loss.

Determination of period for which capital assets are held.—If property was acquired in certain transactions described in sections 112, 113, and 118, the period for which such property is considered to have been held by the taxpayer is not computed from the date such property was acquired by the taxpayer but from a prior date, as provided in section 117 (h).

Application of section 117 in the case of husband and wife.—In the application of section 117 to short-term capital gains and losses, a husband and wife, regardless of whether a joint return or separate returns are made, are considered to be separate taxpayers. Accordingly, the limitation under section 117 (d) (2) on the allowance of losses of one spouse from the sales or exchanges of capital assets held for not more than 18 months is in all cases to be computed without regard to gains and losses of the other spouse upon sales or exchanges of capital assets held for not more than 18 months. In the case of a joint return of a husband and wife, capital transactions of each should be reported in separate schedules.

As to gains and losses from short sales, see section 117 (g). As to gains and losses from distributions in liquidation of corporations, see section 115 (c).

Losses not allowable.—Wash sales.—In the case of any loss claimed to have been sustained from any sale or other disposition of shares of stock or securities where it appears that, within a period beginning 30 days before the date of such sale or disposition and ending 30 days after such date, the taxpayer has acquired (by purchase or by an exchange upon which the entire amount of gain or loss was recognized by law), or has entered into a contract or option so to acquire, substantially identical stock or securities, then no deduction for the loss shall be allowed unless the claim is made in connection with the taxpayer's trade or business. (See section 118.)

Losses in transactions between certain persons.—No deduction shall be allowed in respect of losses from sales or exchanges of property, directly or indirectly—

A. Between members of a family, which is defined for the purpose of this paragraph to include only the taxpayer's brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants;

B. Except in the case of distributions in liquidation, between an individual and a corporation more than 50 percent in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual;

C. Between a grantor and a fiduciary of any trust; or

D. Between a fiduciary of a trust and a beneficiary of such trust.

For the purposes of determining ownership of stock in applying this paragraph, see section 24 (b) (2).

11. Other income.—If you had any taxable income, space for reporting which is not provided elsewhere on the return, enter it as item 11, and explain its nature, using a separate sheet if necessary for that purpose. Include in this item taxable income from annuities and insurance proceeds. Amounts received as an annuity under an annuity or endowment contract shall be included in gross income to the extent of 3 percent of the aggregate premiums or consideration paid for such annuity. If the aggregate of the amounts received and excluded from gross income in years previous to the taxable year equals the aggregate premiums or consideration paid for such annuity, the entire amount received must be included in gross income. (Section 22 (b) (2).)

Amounts received during the taxable year under a life insurance or endowment policy (other than amounts paid by reason of the death of the insured, interest payments on such amounts, and amounts received as annuities) shall be included in gross income if the amounts so received (when added to the amounts received before the taxable year under such policy) exceed the total premiums or consideration paid.

Include also in item 11 dividends on share accounts in Federal savings and loan associations.

12. Total income.—Enter and explain in Schedule I all income (except interest which should be explained in Schedule B) claimed as exempt, but do not include as part of item 12.

13. Contributions paid.—Enter as item 13 the contributions or gifts reported in Schedule H, payment of which was made within the taxable year to or for the use of—

(a) The United States, any State, Territory, or any political subdivision thereof, or the District of Columbia, for exclusively public purposes;

(b) A domestic corporation, or domestic trust, or domestic community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation;

(c) The special fund for vocational rehabilitation authorized by section 12 of the World War Veterans' Act, 1924;

(d) Posts or organizations of war veterans, or auxiliary units or societies of any such posts or organizations, if such posts, organizations, units, or societies are organized in the United States or any of its possessions, and if no part of their net earnings inures to the benefit of any private shareholder or individual; or

(e) A domestic fraternal society, order, or association, operating under the lodge system, but only if such contributions or gifts are to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals.

The amount claimed shall not exceed 15 percent of your net income computed without the benefit of this deduction.

14. Interest.—Enter as item 14 interest on personal indebtedness as distinguished from business indebtedness (which should be deducted under Schedules C and D). Do not include interest on indebtedness incurred or continued to purchase or carry obligations (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation. Any deductions on account of interest should be explained and itemized in Schedule H.

Attention is called to the following limitations on deductions for unpaid expenses and interest provided in section 24 (c):

(c) **Unpaid expenses and interest.**—In computing net income no deduction shall be allowed under section 23 (a), relating to expenses incurred, or under section 23 (b), relating to interest accrued—

(1) If such expenses or interest are not paid within the taxable year or within two and one-half months after the close thereof; and

(2) If, by reason of the method of accounting of the person to whom the payment is to be made, the amount thereof is not, unless paid, includible in the gross income of such person for the taxable year in which or with which the taxable year of the taxpayer ends; and

(3) If, at the close of the taxable year of the taxpayer or at any time within two and one-half months thereafter, both the taxpayer and the person to whom the payment is to be made are persons between whom losses would be disallowed under section 24 (b).

15. Taxes.—Enter as item 15 taxes imposed upon you and paid or accrued during the taxable year, not including taxes on property used in your business or profession and those assessed against local benefits of a kind tending to increase the value of the property assessed. Do not include Federal income taxes, nor estate, inheritance, legacy, succession, gift taxes, taxes imposed upon your interest as shareholder of a corporation which are paid by the corporation without reimbursement from you, nor income taxes claimed as a credit in item 33. Tax withheld or paid under section 801 of the Social Security Act for or in behalf of the employee is a Federal income tax and is not deductible by the employee. Do not include sales taxes unless such taxes were imposed directly upon you by law. No deduction is allowable for any portion of foreign income and profits taxes if a credit is claimed in item 33.

Any deduction on account of taxes should be explained and itemized in Schedule H.

16. Losses from fire, storm, shipwreck, or other casualty, or theft.—Enter as item 16 losses of property not connected with your business or profession, sustained during the year, if arising from fire, storm, shipwreck, or other casualty, or from theft, and if not compensated for by insurance or otherwise.

Explain and itemize losses claimed in Schedule H, setting forth a description of the property, date acquired, cost, subsequent improvements, depreciation allowable since acquisition, insurance, salvage value, and deductible loss.

17. Bad debts.—Enter as item 17 all bad debts other than those claimed as a deduction in Schedule D. State in Schedule H (a) of what the debts consisted, (b) name and family relationship, if any, of the debtor, (c) when they were created, (d) when they became due, (e) what efforts were made to collect, and (f) how they were actually determined to be worthless. Bonds which are ascertained to be worthless and charged off within the taxable year, and which are capital assets, are not to be treated as bad debts, but the loss resulting therefrom shall be considered as a loss from the sale or exchange, on the last day of such taxable year, of capital assets and should be reported in Schedule F.

18. Other deductions.—Enter as item 18 any other authorized deductions for which no space is provided on page 1 of the return. Do not deduct losses incurred in transactions which were neither connected with your trade or business nor entered into for profit. Losses from wagering transactions are allowable only to the extent of the gains derived by you from such transactions. Any deduction claimed should be explained in Schedule H.

Stock and stock rights which become worthless during the taxable year, and which are capital assets, should not be included among other deductions in item 18, but the loss resulting therefrom shall be considered as a loss from the sale or exchange, on the last day of such taxable year, of capital assets and should be reported in Schedule F.

In case you incurred expenses in connection with exempt income (other than interest) or owned any property the income from which is exempt, see section 24 (a) (5) and Regulations 101.

22, 23. Credit for personal exemption and dependents.—Enter as items 22 and 23 the amounts explained in Schedule J-1 and J-2. A single person, or a married person not living with husband or wife, is entitled to a personal exemption of \$1,000. A person who, during the entire taxable year, was the head of a family or was married and living with husband or wife, is entitled to an exemption of \$2,500. If husband and wife file separate returns, the personal exemption may be taken by either or divided between them.

A "head of a family" is an individual who actually supports and maintains in one household one or more individuals who are closely connected with him by blood relationship, relationship by marriage, or by adoption, and whose right to exercise family control and provide for these dependent individuals is based upon some moral or legal obligation.

In addition to the personal exemption, a credit of \$400 may be claimed for each person (other than husband or wife) under 18 years of age, or incapable of self-support because mentally or physically defective, who received his or her chief support from the taxpayer. This credit may be allowed only to the person who furnishes the chief support, and may not be divided between two individuals.

If the status of the taxpayer, insofar as it affects the personal exemption or credit for dependents, changes during the taxable year, the personal exemption and credit shall be apportioned in accordance with the number of months before and after such change. For the purpose of such apportionment a fractional part of a month shall be disregarded unless it amounts to more than half a month, in which case it shall be considered as a month. For example, if a child became 18 years of age on June 16, 1938, the taxpayer will be allowed a credit of \$200 for such dependent.

25. Credit for interest on Government obligations, etc.—Enter as item 25 interest on Government obligations, etc., reported as item 5, and also dividends on share accounts in Federal savings and loan associations reported in item 11.

26. Earned income credit.—Enter as item 26 the amount of earned income credit computed in Schedule K-1 or K-2.

"Earned income" means wages, salaries, professional fees, and other amounts received as compensation for personal services actually rendered, but does not include any amount not included in gross income, nor that part of the compensation derived by the taxpayer for personal services rendered by him to a corporation which represents a distribution of earnings or profits rather than a reasonable allowance as compensation for the personal services actually rendered. In the case of a taxpayer engaged in a trade or business in which both personal services and capital are material income-producing factors, a reasonable allowance as compensation for the personal services actually rendered by the taxpayer, not in excess of 20 percent of his share of the net profits of such trade or business, shall be considered as earned income. "Earned income deductions" means such deductions as are allowable by section 23, for the purposes of computing net income, and are properly allocable to or chargeable against earned income. "Earned net income" means the excess of the amount of the earned income over the sum of the earned income deductions. The earned income credit allowable to each spouse in a joint return is the same as is allowable to each spouse in separate returns; however, the earned income, earned income deductions, earned net income, and net income of each spouse must be shown separately.

29. Surtax.—The surtax is computed at the graduated rates shown in the table below. Its application may be illustrated by the following example: If your surtax net income (item 24) is \$9,261.84, the surtax on \$8,000 is \$180 and the surtax on the excess of \$1,261.84 is 6 percent of that amount, or \$75.71, making a total surtax of \$255.71 to be entered as item 29.

SURTAX RATES

Amount of surtax net income	Rate per cent	Total surtax	Amount of surtax net income	Rate per cent	Total surtax
A	B	C	A	B	C
\$0 to \$4,000	—	—	\$62,000 to \$68,000	39	\$14,000
4,000 to 6,000	4	\$80	68,000 to 74,000	43	16,580
6,000 to 8,000	5	180	74,000 to 80,000	47	19,400
8,000 to 10,000	6	300	80,000 to 90,000	51	24,500
10,000 to 12,000	7	440	90,000 to 100,000	55	30,000
12,000 to 14,000	8	600	100,000 to 150,000	58	59,000
14,000 to 16,000	9	780	150,000 to 200,000	60	89,000
16,000 to 18,000	11	1,000	200,000 to 250,000	62	120,000
18,000 to 20,000	13	1,260	250,000 to 300,000	64	152,000
20,000 to 22,000	15	1,560	300,000 to 400,000	66	218,000
22,000 to 26,000	17	2,240	400,000 to 500,000	68	286,000
26,000 to 32,000	19	3,380	500,000 to 750,000	70	461,000
32,000 to 38,000	21	4,640	750,000 to 1,000,000	72	641,000
38,000 to 44,000	24	6,080	1,000,000 to 2,000,000	73	1,371,000
44,000 to 50,000	27	7,700	2,000,000 to 5,000,000	74	3,591,000
50,000 to 56,000	31	9,560	5,000,000 up	75	—
56,000 to 62,000	35	11,660			

32. Income tax paid at the source.—Enter as item 32, 2 percent of interest on bonds on which a Federal income tax was paid at the source by the debtor corporation.

33. Income tax paid to a foreign country or United States possession.—If, in accordance with section 131 (a), a credit is claimed in item 33 for income, war-profits, and excess-profits taxes paid to a foreign country or a possession of the United States, submit Form 1116 with your return with the receipts for such payments. In case credit is sought for taxes accrued, the form must have attached to it a certified copy of the return on which the tax was based, and the Commissioner may require a bond on Form 1117 for the payment of any tax found due if the tax when paid differs from the credit claimed.