

1940

GENERAL INSTRUCTIONS

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A. WHO MUST MAKE A RETURN.—Every citizen and resident of the United States having during the taxable year *gross income* (income derived from any source whatever, unless exempt from tax by law) in an amount specified below, *regardless of the amount of net income*, shall make a return if:

(1) *Single, or married and not living with husband or wife for any part of the taxable year.* If having a gross income of \$800 or over.

(2) *Married and living with husband or wife for the entire taxable year.* If each has income and their combined gross income is \$2,000 or over, they must each make a return or file a joint return. If only one has income and his gross income is \$2,000 or over, only that one is required to make a return.

(3) *Married and living with husband or wife for only part of the taxable year.* If each has income and their combined gross income is \$2,000 or over, or equal to, or in excess of, their total personal exemption (not including credit as head of a family or for dependents), they must each make a return or file a joint return. If only one has income and his gross income is \$2,000 or over, or equal to, or in excess of, his personal exemption (not including credit as head of a family or for dependents), only that one is required to make a return. (See Specific Instruction 22 as to personal exemption.)

Joint return.—May be filed by husband and wife *only* if they are (1) both citizens or resident of the United States and (2) living together at the end of the taxable year. A joint return is permissible even though one has no gross income.

Deceased individuals.—Return required on Form 1040 or 1040A if gross income to date of death is \$800 or over, if single, or married and not living with spouse for any part of the taxable year, or equal to, or in excess of, credit for personal exemption (not including credit as head of a family or for dependents), if married and living with spouse for all or any part of the taxable year. The return for a decedent shall include all items of income and deductions accrued up to the date of death, regardless of the fact that the decedent may have kept his books on a cash basis or kept no books.

B. FORM OF RETURN.—Individuals (1) whose gross income exceeds \$5,000, or (2) who have any income or losses from rental or sale of property, or (3) make returns on accrual basis, or (4) make returns for a fiscal year, or (5) conduct their own business or profession, or are members of a partnership, use Form 1040. Nonresident aliens use Form 1040B or 1040NB. Fiduciaries use Form 1041. All other individuals use Form 1040A.

C. FILING OF RETURNS AND PAYMENT OF TAX.—File on or before 15th day of 3d month following close of taxable year with collector for the district in which the taxpayer has his legal residence or principal place of business. If the taxpayer has no legal residence or place of business in United States, file with collector at Baltimore, Md. The taxpayer's home address must be given and a permanent business address may be added. Pay in cash at collector's office or by check or money order payable to "Collector of Internal Revenue." Pay in full with return or in four equal installments, on or before the 15th day of the 3d, 6th, 9th, and 12th month from close of taxable year.

D. PENALTIES.—Severe penalties are imposed for not filing a return, for filing a false or fraudulent return, or failing to file on time.

E. AFFIDAVITS.—Return must be sworn to by taxpayer or his agent. Return may be made by agent if taxpayer (1) is too ill to make it or (2) is absent from United States for 60 days before due date. Power of attorney on Form 935 or 936 (husband and wife) must accompany return made by agent. Person preparing return must execute affidavit on page 4. Return may be sworn to before any collector, deputy collector, or internal revenue agent (without charge), or other person authorized by law to administer oaths for general purposes, except taxpayer's agent.

F. RECEIVED OR ACCRUED INCOME.—If books are kept on

accrual basis, report all income accrued, even though not received or entered on books, and expenses incurred even though not paid. If books are not kept on accrual basis, or if no books are kept, report all income actually or constructively received, and all expenses paid.

G. ITEMS EXEMPT FROM TAX.—Explain items claimed to be exempt in Schedule I, except interest to be reported in Schedule B.

1. Interest on governmental obligations:

(a) *Entirely exempt.*—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 the United States issued on or before September 1, 1917; and (4) Treasury notes, Treasury bills, Treasury certificates of indebtedness, postal savings obligations, adjusted service bonds, and certain other obligations of the United States.

(b) *Partially exempt.*—The interest on (1) United States savings bonds and Treasury bonds owned in excess of \$5,000 and (2) obligations of instrumentalities of the United States is subject only to surtax.

2. Proceeds of insurance policies.—The proceeds of life insurance policies, paid by reason of the death of the insured, are exempt. If any part of the proceeds is held by the insurer under an agreement to pay interest, the interest is taxable. Amounts received under a life insurance or endowment policy, not payable by reason of the death of the insured, are not taxable until the aggregate of the amounts received exceeds the premiums or consideration paid for the policy. See Specific Instruction 11 as to taxation of annuities.

3. Federal savings and loan associations.—Dividends on share accounts in Federal savings and loan associations are subject only to surtax.

4. Miscellaneous items wholly exempt from tax:

(a) Gifts (not received as a consideration for service rendered) and money and property acquired by bequest, devise, or inheritance (but income therefrom is taxable);

(b) 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;

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

(d) 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 in time of war; and

(e) 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, a bona fide nonresident for more than 6 months during the taxable year (no deduction may be taken for any amount properly allocable to or chargeable against amounts so excluded).

H. DEPRECIATION AND DEPLETION.—A reasonable allowance for exhaustion, wear and tear, including obsolescence, of property used in trade or business may be deducted, based on cost if acquired by purchase after February 28, 1913. If acquired before March 1, 1913, or other than by purchase, see section 114.

For depletion deduction, see sections 23 (m) and 114 and Regulation 103.

I. INFORMATION AT SOURCE.—Every person making payments of (1) interest, rents, commissions, or other fixed or determinable income of \$800 or more during the calendar year 1940 to an individual, a partnership, or a fiduciary, or (2) salary or wages of \$800 or more to a single person or \$2,000 or more to a married person shall make a return on Forms 1096 and 1099.

J. STOCK OWNED IN FOREIGN CORPORATIONS AND PERSONAL HOLDING COMPANIES.—If at any time during the year you owned directly or indirectly stock of a foreign corporation, or a personal holding company (section 501), attach a statement showing name and address of each such company and total number of shares of each class of outstanding stock owned. If at any time during the year you owned stock in a foreign personal holding company (section 331), include in income as a dividend the amount required by section 337, and if you owned 5 percent or more in value of the outstanding stock of such company, attach a statement giving in detail the information required by section 337 (d).

SPECIFIC INSTRUCTIONS

(Numbered to correspond with item numbers on page 1 of return)

1. SALARIES, ETC.—Include compensation received as an officer or employee of a State or political subdivision or any agency or instrumentality thereof. For treatment of compensation for a period of 5 years or more, see section 107.

2. DIVIDENDS.—Enter total of all taxable dividends. Enter in Schedule I all dividends claimed to be nontaxable. Enter in item 11 dividends on share accounts in Federal savings and loan associations.

6, 7. INCOME FROM PARTNERSHIPS, FIDUCIARIES, ETC., WHOSE TAXABLE YEAR ENDS WITHIN THE TAXABLE YEAR COVERED BY THIS RETURN.—Enter as item 6 your share of profits (whether received or not) or losses of a partnership (including a syndicate, pool, etc., not taxable as a corporation) except capital gains and losses, which enter in Schedule F. Enter as item 7 income from an estate or trust. Enter in Schedule B your share of interest on obligations of the United States, etc., owned by partnership, estate, or trust. Include in item 13, and explain in Schedule H, your share of any contribution or gift, payment of which was made by the partnership within its taxable year. Enter in items 32 and 33, respectively, your share of credits for Federal income tax paid at source and foreign income taxes.

8. RENTS AND ROYALTIES.—Include rent received in property or

crops. Report crops received on crop-share basis in year in which disposed of (unless return is made on accrual basis).

9. BUSINESS OR PROFESSION.—Fill in Schedule D. Farmers keeping no books of account, or books on cash basis, must attach Form 1040F. A taxpayer electing to include in gross income amounts received during the year as loans from the Commodity Credit Corporation should file with his return a statement showing the details of such loans. (See section 123.)

If installment method is used, attach schedule showing separately for years 1937, 1938, 1939, and 1940: (a) Gross sales; (b) cost of goods sold; (c) gross profits; (d) percentage of profits to gross sales; (e) amount collected; (f) gross profit on amount collected.

Bad debts may be deducted either (1) when ascertained to be wholly or partially worthless, or (2) by a reasonable addition to a reserve. (No change of method without permission of Commissioner.)

10. GAINS AND LOSSES FROM SALES OR EXCHANGES OF CAPITAL ASSETS AND OTHER PROPERTY.—Report details in Schedules F and G.

"Capital assets" defined.—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but not stock in trade or other property of a kind which would properly be

included in his inventory 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 of a character which is subject to the allowance for depreciation provided in section 23 (1).

Description of property.—State following facts: (a) For real estate, location and description of land and improvements; (b) for bonds or other evidences of indebtedness, name of issuing corporation, particular issue, denomination and amount; and (c) for stocks, name of corporation, class of stock, number of shares, and capital changes affecting basis (including nontaxable distributions).

Basis—In determining GAIN in case of property acquired before March 1, 1913, use 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 use cost so adjusted. If the property was acquired after February 28, 1913, use cost, except as otherwise provided in section 113.

Losses on securities becoming worthless.—If (1) shares of stock become worthless during the year or (2) corporate securities with interest coupons or in registered form are ascertained to be worthless and charged off during the year, and are capital assets, the loss therefrom shall be considered as from the sale or exchange of capital assets as of the last day of such taxable year.

Classification of capital gains and losses—The phrase “short-term” applies to gains and losses from the sale or exchange of capital assets held for 18 months or less; the phrase “long-term” to capital assets held for more than 18 months.

Limitation on short-term capital losses.—Short-term capital losses shall be allowed only to the extent of short-term capital gains. However, any net short-term capital loss (not in excess of the net income for the year involved) may be carried over in the succeeding year and applied against the short-term capital gains not already offset by short-term capital losses in such year. The carry-over is restricted to 1 year.

Alternative tax.—In the case of a net long-term capital gain or loss, an alternative tax is imposed in lieu of the normal tax and surtax imposed upon net income. (See Computation of Alternative Tax, Schedule F.) In calculating the alternative tax in the case of a long-term capital loss, the base (1) for computing the 15 percent limitation with respect to the deduction for charitable contributions is the “ordinary net income” as shown in line 3, Computation of Alternative Tax, Schedule F, increased by item 13, page 1, and (2) for computing the earned income credit is the “ordinary net income” as adjusted for the charitable contributions deduction.

Capital gains and losses of husband and wife.—A husband and wife, whether a joint or separate return is made, are separate taxpayers insofar as short-term capital gains and losses are concerned. Hence, such gains and losses of one spouse may not be offset against the gains and losses of the other. In a joint return, such limitation does not apply to long-term capital gains and losses, but capital transactions of each must be shown in separate schedules.

“Wash sales” losses.—Loss from sale or other disposition of stock or securities cannot be deducted unless sustained in connection with the taxpayer's trade or business, if, within 30 days before or after the date of sale or other disposition, 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 to acquire, substantially identical stock or securities.

Losses in transactions between certain persons.—No deduction is allowable for losses from sales or exchanges of property directly or indirectly between (a) members of a family, (b) a corporation and an individual owning more than 50 percent of its stock (liquidations excepted), (c) a grantor and fiduciary of any trust, or (d) a fiduciary and a beneficiary of the same trust.

11. OTHER INCOME.—Enter any other taxable income, including taxable income from annuities and insurance proceeds, dividends on share accounts in Federal savings and loan associations, and earnings of minor children if parent is legally entitled thereto. 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 equals the aggregate premiums or consideration paid for such annuity, the entire amount thereafter received must be included in gross income.

13. CONTRIBUTIONS PAID.—Enter (not to exceed 15 percent of your net income computed without the benefit of this deduction) contributions or gifts, payment of which was made within the year to or for the use of—

(a) A corporation, trust, or community chest, fund, or foundation, created or organized in the United States or in any possession thereof or under the law of the United States or of any State or Territory or of any possession of the United States, 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;

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

(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.

14. INTEREST.—Enter interest on personal indebtedness as distinguished from business indebtedness (which should be entered in Schedules C and D). For limitations on deductions for unpaid expenses and interest, see section 24 (c).

15. TAXES.—Enter taxes imposed on you and paid or accrued during the taxable year, except taxes entered in Schedules C and D. Do not include taxes assessed against local benefits, Federal income taxes or estate, inheritance, legacy, succession, gift taxes, taxes imposed on 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. Federal social security and employment taxes paid by or for an employee are

not deductible by the employee.

16. LOSSES.—Enter property losses (not claimed in Schedule D), from fire, storm, shipwreck, or other casualty, or from theft, not compensated for by insurance or otherwise. Explain in Schedule H giving description of property, date acquired, cost, subsequent improvements, depreciation allowable, insurance, salvage value and deductible loss.

17. BAD DEBTS.—Enter bad debts other than those claimed in Schedule D. Show in Schedule H: (a) of what the debts consisted; (b) name and family relationship, if any, of debtor; (c) when created; (d) when due; (e) efforts made to collect; and (f) how determined to be worthless. Enter in Schedule F losses from corporate securities with interest coupons or in registered form ascertained to be worthless and charged off within the year, and which are capital assets.

18. OTHER DEDUCTIONS.—Enter other authorized deductions, including net operating loss deduction allowed by section 23 (s). Every taxpayer claiming a deduction due to a net operating loss for the preceding taxable year shall file with his return the statement required by section 19.122-1, Regulations 103.

Do not deduct losses in transactions not connected with your trade or business or not entered into for profit. Losses from wagering transactions are allowable to the extent of gains therefrom.

22, 23. CREDIT FOR PERSONAL EXEMPTION AND DEPENDENTS.—A single person, or a married person not living with spouse, is allowed a personal exemption of \$800. A person who, during the entire taxable year, was the head of a family or was married and living with spouse, is allowed an exemption of \$2,000. On separate returns, the personal exemption may be taken by either husband or wife or divided between them.

A “head of a family” is one who supports in one household one or more dependent individuals closely connected with him by blood relationship, relationship by marriage, or by adoption, and whose right to exercise family control is based upon some moral or legal obligation.

A credit of \$400 is allowed for each person (other than husband or wife) under 18 years of age, or incapable of self-support because mentally or physically defective, whose chief support was received from the taxpayer.

If taxpayer's status, with respect to personal exemption and credit for dependents, changed during the taxable year, such exemption and credit shall be apportioned according to the number of months before and after such change. A fractional part of a month is disregarded unless it exceeds half a month, when it shall be considered a month.

25. CREDIT FOR INTEREST, ETC.—Enter interest reported as item 5, and also dividends on share accounts in Federal savings and loan associations reported in item 11.

26. EARNED INCOME CREDIT.—“Earned income” means wages, salaries, professional fees, and other amounts received as compensation for personal services actually rendered. Where a taxpayer is 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 net income” means the excess of the amount of the earned income over the sum of the “earned income deductions,” which are the ordinary and necessary expenses properly chargeable against earned income. In a joint return each spouse is allowed the same earned income credit allowable in separate returns. They must show separately the earned income, earned income deductions, earned net income, and net income of each spouse.

29. SURTAX.—The computation of the surtax, shown in the table below, is illustrated as follows: If your surtax net income (item 24) is \$9,261.84, the surtax on \$8,000 is \$200 and the surtax on the excess of \$1,261.84 is 8 percent of that amount, or \$100.95, making a total surtax of \$300.95 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			\$60,000 to \$70,000	47	\$20,880
4,000 to 6,000	4	\$80	70,000 to 80,000	50	25,880
6,000 to 8,000	6	200	80,000 to 90,000	53	31,180
8,000 to 10,000	8	360	90,000 to 100,000	56	36,780
10,000 to 12,000	10	560	100,000 to 150,000	58	65,780
12,000 to 14,000	12	800	150,000 to 200,000	60	95,780
14,000 to 16,000	15	1,100	200,000 to 250,000	62	126,780
16,000 to 18,000	18	1,460	250,000 to 300,000	64	158,780
18,000 to 20,000	21	1,880	300,000 to 400,000	66	224,780
20,000 to 22,000	24	2,360	400,000 to 500,000	68	292,780
22,000 to 26,000	27	3,440	500,000 to 750,000	70	467,780
26,000 to 32,000	30	5,240	750,000 to 1,000,000	72	647,780
32,000 to 38,000	33	7,220	1,000,000 to 2,000,000	73	1,337,780
38,000 to 44,000	36	9,380	2,000,000 to 5,000,000	74	3,597,780
44,000 to 50,000	40	11,780	5,000,000 up	75	
50,000 to 60,000	44	16,180			

32. INCOME TAX PAID AT SOURCE.—Enter 2 percent of interest on bonds on which Federal income tax was paid by debtor corporation.

33. FOREIGN TAX CREDIT.—If credit is claimed for taxes paid to a foreign country or possession of United States, submit Form 1116 and receipts for such payments. If credit is claimed for taxes accrued, attach to Form 1116 certified copy of return on which tax was based.

35. DEFENSE TAX.—The amount of the tax to be entered as item 35 shall not exceed 10 percent of the amount by which the net income exceeds the tax computed without reference to defense tax.