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THE EXCESS PROFITS TAX ACT OF 1940

SANFORD D. BEECHER* and RALPH E. EVANS**

INTRODUCTION

The much discussed and criticized Excess Profits Tax Act of 1940 is extremely complicated because every other Federal revenue measure plays some part in its application and because sections of the new act often modify each other. This discussion is limited to a summary of the act itself with little interpretation offered for the obvious reason that the same would be pure conjecture at this time. The new act has not yet had the benefit of court interpretation and as yet there are not even available regulations, interpretations or forms from the Commissioner of Internal Revenue. Experience with the Excess and War Profits Tax statutes of 1917 and 1918 is not of great benefit and decisions under those acts provide only hazy guideposts.

The Excess Profits Tax of 1940 does not displace the income tax which corporations must pay nor does it have any connection with the surtax on corporate income provided in the First Revenue Act of 1940. The Federal Capital Stock Tax remains in effect, together with the "old" Excess Profits Tax, which now becomes known as the "Declared Value Excess Profits Tax." The new tax is effective for five years beginning after December 31, 1939.

The President of the United States in a message to Congress recommended "A steeply graduated Excess Profits Tax, to be applied to all individuals and all corporate organizations without discrimination." The act as it was passed only applies to corporations and so far as individuals are concerned, the President's request went unheeded.

The original motivating force behind the President's request was for Congress to insure the Nation against war profiteers, both individual and corporate. From the fact that the act applies to all corporations regardless of whether or not war contracts are held and from the fact that only corporations are subject thereto, it is obvious that the original purpose of the act was lost somewhere along its long and tortuous legislative path.

However, the prevention of the war profiteering features of the statute are retained. We are faced, therefore, with a hybrid creature retaining its original method after it lost its original purpose.

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A broad general view produces such a simple picture that it is difficult to understand how the act became so complicated that one writer felt prone to remark "the 1917 and 1918 Excess and War Profits Tax Acts, which the business world condemned because of their complications, were masterpieces of simplicity in comparison with the 1940 Act."

There follows this article an outline and work sheet for the computation of excess profits tax under the act. This outline was prepared by Commerce Clearing House, Inc., whose permission to include the same in this article is gratefully acknowledged. The outline covers both methods of determining the excess profits tax of the average corporation. It assumes, however, that the corporation is a domestic one on a calendar year basis, which was organized prior to December 31, 1935, having no intercompany relationships, no contracts subject to the Merchant Marine Act, and no abnormal items under Section 721 of the Excess Profits Tax Act of 1940.

SYNOPSIS OF THE ACT

The tax is imposed on "adjusted excess profits net income" at the following rates:

First	\$20,000	.....	25%
Next	\$30,000	.....	30%
Next	\$50,000	.....	35%
Next	\$150,000	.....	40%
Next	\$250,000	.....	45%
Over	\$500,000	.....	50%

"Adjusted excess profits net income" is "excess profits net income" (as defined in the act) less the "excess profits credit" plus a specific exemption of \$5,000.00. The base of the tax may be expressed by the following formula:

$$\begin{array}{rcl}
 \text{Excess profits net income} & = & X \\
 \text{Excess profits credit plus \$5,000} & = & Y \\
 \text{Adjusted excess profits net income} & = & X-Y
 \end{array}$$

The difficulty in the problem arises from the explanation of the terms contained in the simple formula above. The excess profits *credit* is determined in one of two ways at the election of the taxpayer. The taxpayer may elect to determine the credit under the income method provided in the act or under the invested capital method, both of which will be discussed below.

Excess profits net income is the normal-tax net income as defined by Section 13 (a) (2) of the Internal Revenue Code, less certain specified adjustments. Two separate sets of adjustments to normal-tax net income are provided. If the taxpayer elects to have its excess profits credit determined under the income method, one set of adjustments must be made to normal-tax net income in arriving at ex-

cess profits net income. If the taxpayer elects to have its excess profits credit determined under the invested capital method, the other set of adjustments must be made to normal-tax net income in order to arrive at the excess profits net income.

The reason behind the adjustments to normal-tax net income in arriving at excess profits net income is explained by the House Ways and Means Committee as an attempt to remove inequities and hardships by eliminating unusual and non-recurring items. The provisions for these adjustments follow through with the method of the act, although the original purpose of the act (elimination of war profits) has vanished, since the result of the adjustments is the determination of an excess profits net income which reflects more nearly the actual operating experience of the taxpayer.

EXCESS PROFITS NET INCOME WHERE THE EXCESS PROFITS CREDIT IS DETERMINED UNDER THE *Income Method*

If a taxpayer elects to have its excess profits credit computed under the income method (which will be explained hereafter), the following adjustments must be made to normal-tax net income to arrive at excess profits net income for the taxable year:

1. The normal income tax, including the defense tax, must be deducted but the tax on corporations improperly accumulating surplus is not deductible.
2. Capital gains and losses from the sale or exchange of capital assets held for more than 18 months must be excluded. Property subject to depreciation is not a capital asset for normal-tax purposes, so that gains or losses from the sale or exchange thereof is taxable or deductible in full for normal-tax purposes. However, for excess profits tax purposes, the excess of gains over losses upon such property held more than 18 months must be excluded.
3. If any evidence of indebtedness is held by the taxpayer for more than 18 months, income derived from the retirement or discharge of the same must be deducted.
4. Refunds of the tax paid under the A. A. A. Act of 1933 together with interest thereon must be excluded.
5. If a deduction for any bad debt was allowed in any taxable year prior to January 1, 1940, any amount recovered thereon must be deducted.
6. In arriving at normal-tax net income, a corporation is only allowed to deduct 85% of domestic corporation dividends received. For the purpose of arriving at excess profits net income, dividends received on the shares of domestic corporations are deductible without limitation.

EXCESS PROFITS NET INCOME WHERE THE TAXPAYER ELECTS TO
HAVE ITS EXCESS PROFITS CREDIT DETERMINED UNDER
THE *Invested Capital Method*

Should a taxpayer elect to compute its excess profits credit under the invested capital method, two further adjustments to normal-tax net income must be made in arriving at excess profits net income:

(a) The dividends received from shares of domestic *and foreign* corporations are deductible without limitation except those on shares of foreign personal-holding companies.

(b) Included in the invested capital serving as a basis for this method of computing the excess profits credit is 50% of borrowed capital. For this reason normal-tax net income must be adjusted by deducting 50% of interest on indebtedness included in borrowed capital (explained hereafter).

In determining the excess profits credit under the invested capital method, the act allows government obligations (local, state and federal, the income from which is wholly or partially exempt from normal tax) to be included in admissible assets if, for the purpose of determining excess profits net income, there was included the exempt interest upon the government obligations. Since the present exempt interest rate on government obligations is low, the taxpayer is offered a considerable concession in being allowed to include the obligations themselves in invested capital for the calculation of the credit.

EXCESS PROFITS CREDIT

It has now been explained how excess profits net income is determined. We must now consider the excess profits *credit* deductible from the excess profits net income in arriving at the taxable adjusted excess profits net income.

a. Income Method

The fundamental theory of the law where the income method has been elected for the determination of the excess profits credit is to impose tax on the excess of the income for the taxable year over the average income for four years, 1936 to 1939 inclusive, known as the base period. The four-year average is inserted in order that normal business fluctuation from year to year might be taken into account and in order that large earnings in one year as opposed to small earnings in another might not produce a distorted picture.

The way in which income for the taxable year must be adjusted under this method of arriving at the excess profits credit has been explained. We now take up the way in which the excess profits *credit* itself under the average earning method is determined. This credit consists of three elements, 95% of the average base period net income as hereinafter defined, the addition of 8% of the net capital addition, or the deduction of 6% of the net capital reduction.

The base period includes the taxable years 1936, 1937, 1938 and 1939. The starting point is the normal-tax net income, which is to be determined under the laws as they existed in each of these years. A corporation will find it necessary merely to refer to its federal income tax as it was assessed and adjusted for each of these years. However, the taxpayer will have to take into consideration the present provisions of the Internal Revenue Code (sections 23 (g) (2) and (k) (2) I. R. C.), under which securities having become worthless are to be treated as capital losses and which provisions are retroactive for the purpose of this act. If the securities were held less than 18 months, the capital loss is a short term one; if held more than 18 months, a long term one. If in any taxable year beginning after December 31, 1939, the short term capital losses of a corporation exceed its short term capital gains, such excess may be carried forward to the succeeding year (section 117, I. R. C.).

Once the taxpayer has made this adjustment to its normal-tax net income for each year of the base period, it must go a step further and adjust the same as was done in determining its excess profits net income for the taxable year when adjustments 1, 2, 3, and 6 were made. Certain other adjustments are then in order. It is to be noted that it is to the taxpayer's advantage to have its excess profits credit as large as possible since the larger the credit, the smaller the taxable adjusted excess profits net income.

(a) Where the taxpayer retires or discharges any evidence of indebtedness that has been outstanding more than 18 months, no deduction is required for loss or expense paid or for any unamortized discount. Any income therefrom must also be eliminated.

(b) If a loss is suffered of the "useful value of property" for any unusual or unexpected reason, the portion of the loss not covered by insurance is not required to be deducted (before this provision applies, the reason for the loss practically must be an "Act of God").

(c) For the purpose of determining the base period net income, the repayment of processing taxes must be excluded from the deduction to the extent that it exceeds the amount collected and not paid to the Federal Government. The act is confused on this point and the applicability of the Unjust Enrichment Tax is not explained.

(d) Where the taxpayer contracted a liability of such nature or size that it was abnormal in the taxpayer's business, or if the amount thereof was disproportionate to the amount of such liability in the four previous taxable years, the same need not be deducted.

(e) Expenditures of a taxpayer for drilling and development costs of oil or gas wells or in the preparation for the same must be eliminated from the deduction to the extent that they are abnormal.

(f) Dividends received upon the shares of *domestic* corporations must be entirely deducted. The effect of this provision is to eliminate entirely such dividends from adjusted excess profits net income since the same are also eliminated from excess profits net income.

Attention is invited that the effect of the foregoing adjustment is to place base period net income upon a normal operating foundation, which when serving as part of the excess profits credit, will cause a taxable adjusted excess profits net income reflecting true conditions during the taxable period.

The net capital addition or the net capital reduction of a taxpayer is to be considered also in determining the excess profits credit. Capital additions are the excess of the aggregate amounts of money and property paid in for stock, as a contribution to capital, or as paid in surplus during the taxable year over the aggregate reductions in money and property paid in for stock, as contributions to capital, or as paid in surplus. Certain refinements, which for our purpose are unimportant, are contained in the act at this point. If it is determined that the taxpayer has a net capital addition during the taxable year, 8% thereof is added as an item in the excess profits credit. If it is determined that the taxpayer had a net capital reduction during the taxable year, 6% thereof is subtracted in the calculation of excess profits credit. In finally computing the excess profits credit under the average earnings basis, 95% of the average base period net income is determined and 8% of the net capital addition is added thereto, or 6% of the capital reduction is subtracted therefrom.

If a corporation was in existence for only a part of the 48 months of the base period, it may elect to compute its excess profits credit under either the "average income" method or the "invested capital" method. If it chooses the income method, it will be entitled, for each taxable year of 12 months during which it was not in existence, to a constructive excess profits net income of 8% of its invested capital for the first day of its first taxable year beginning after December 31, 1939. Such invested capital is to be determined, however, after reduction by the ratio of inadmissible assets effective in reduction of the average invested capital of the preceding taxable year. Where there is a remainder of less than 12 months of the base period during which the corporation was not in existence, the amount of constructive net income determined for a full year is to be prorated according to the number of days in the short period.

If a corporation was not in existence during any part of the base period, or if it fails to file its return when due, its excess profits credit is to be determined by the invested capital method.

Certain other adjustments must be made in the case of reorganizations and in the case of various tax-free exchanges. Although the principles are not particularly difficult, the detailed application is too complicated for discussion herein.

b. Invested Capital Method

There has now been explained the manner in which taxable adjusted excess profits net income under the average earnings method is determined, to-wit, by the subtraction from excess profits net income computed under the average earnings method of the excess profits credit calculated by the average earnings method. It has been indicated in addition how excess profits net income is arrived at where the taxpayer elects to have its excess profits *credit* determined under the invested capital method. We must take up now the way in which the excess profits credit itself is computed under the invested capital method.

When the invested capital of the corporation has been determined (as will be explained hereafter), 8% thereof is taken in order to produce the allowable credit.

Invested capital is composed of (1) equity invested capital and (2) borrowed invested capital. Equity invested capital is made up in the main of four principal elements: money paid in, property paid in, so-called stock dividends, and accumulated earnings and profits.

Money paid in includes any money paid to the corporation as capital. This means money paid into the corporation as an investment on the assumption that the business experience of a corporation will be such as to produce a direct return to the investor from operations. This type of money paid in is to be distinguished from a loan to the corporation or from the purchasing of corporate bonds or other forms of corporate indebtedness.

Property paid in is generally that transferred to a corporation for shares, or as paid in surplus, or as a contribution to capital. It is well known that for purposes of normal income tax, property values must be adjusted in order to determine the proper amounts of depreciation allowable as deductions from normal income. For purposes of the excess profits credit, the amount considered as the value of property paid in is the unadjusted income tax cost of the property. It is apparent that depreciation has already been charged against income during the period when the property is held and is reflected in the total accumulated earnings and profits of the corporation at the beginning of the taxable year.

Stock dividends. These are distributions by a corporation in the form of stock of the corporation considered as a distribution of earnings and profits, and are treated as a part of invested capital for the reason that the same are presumed to be a re-investment of funds in the enterprise. This particular element may present many niceties through legal interpretation in the administration of the act since such dividends are to be distinguished from situations where common stock is distributed to common stockholders without resulting in any effect upon accumulated earnings and profits.

Accumulated earnings and profits. These are also a part of invested capital, but only those existing at the beginning of the taxable year. Here again we are faced with the necessity of making adjustments in order to comply with the act. Such items as contingency reserves, write-downs of purchased good will, etc. must be added back to surplus and there must be reductions for items of unrealized appreciation.

There must also be reductions for distributions made prior to the taxable year, which were not out of accumulated earnings and profits and there must be deducted distributions made during a taxable year which were not out of accumulated earnings and profits of that taxable year.

A presumption is contained in the act that if a dividend is paid within sixty days after the beginning of any taxable year, which does not exceed accumulated earnings and profits as of the beginning of the taxable year, it will be considered as having been paid on the last day of the preceding taxable year.

Certain intricacies in the treatment of distributions are also to be found in the act upon this point, but our purpose would not be served if this discussion were made any more technical.

Included in invested capital along with equity invested capital is borrowed capital. However, borrowed capital is only includible in invested capital to the extent of 50%. In other words, the borrowed capital is calculated, 50% thereof taken and added to equity invested capital, in arriving at invested capital.

Borrowed invested capital is composed of the outstanding indebtedness of a corporation, excluding interest, which is evidenced by note, bond, etc., and the installments or partial payments to a corporation upon contracts with a foreign government made within thirty days after the enactment of the Second Revenue Act of 1940.

For the purpose of determining the excess profits credit under the invested capital method, the equity invested capital, described above, must be computed for each day of the taxable year and then transposed into the average equity invested capital for the year. The borrowed invested capital must be reduced to a yearly average in the same way, 50% thereof taken and added to the average equity invested capital to produce the average invested capital.

INADMISSIBLE ASSETS ADJUSTMENT

One further adjustment must be made. This is known as the inadmissible assets adjustment. In arriving at invested capital, certain assets are not admissible and must be removed from invested capital before the credit under this method can be determined. Once the average invested capital has been determined, as

described above, it must be reduced by an amount computed by applying to the average invested capital a fraction, the numerator of which is total inadmissible assets, and the denominator of which is the total of admissible and inadmissible assets. Needless to say, both inadmissible and admissible assets for the purpose of this fraction must be determined upon an average yearly basis following their computation upon a daily basis.

When the average adjusted invested capital figure is arrived at, 8% is taken and the resulting figure subtracted from excess profits net income to arrive at a taxable adjusted excess profits net income.

SCOPE OF THIS ARTICLE

This article has been confined to a discussion of the fundamentals of excess profits taxation under the Excess Profits Tax portion of the Second Revenue Act of 1940. The discussion has been limited to the application of the act to the normal corporation. This article does not include a discussion of the applicability of the act to a foreign corporation (foreign to the United States), nor does it take up the manner in which the act works upon personal service corporations, corporations having contracts under the Merchant Marine Act of 1936, and no mention has been made of the applicability of the act to a system of corporations. Technical provisions apply to the filing of consolidated reports which may be offered by corporate set-ups of certain natures under regulations promulgated by the Commissioner of Internal Revenue. The statutory provisions are complicated and apt to confuse and the regulations of the Commissioner have not yet been issued. A summary of exempt corporations may be easily located by reference to the act itself.

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OUTLINE AND WORK SHEET FOR COMPUTATION

INCOME METHOD

For Determining Excess Profits Tax Liability for 1940

Normal tax net income for taxable year 1940 (Code Sec. 13 (a) (2)) ¹	\$	.....	\$
Amount of adjustment as per Schedule 1		.....
Excess profits tax net income		.....	\$

Less credits:

95% of average base period net income (Schedule 2)..... \$

Plus 8% of net capital addition during taxable year (Schedule 3).....

or

Minus 6% of net capital reduction during taxable year (Schedule 3).....

Plus specific exemption (\$5,000).....	\$	.....	\$
Adjusted excess profits net income		.....	\$

[If this figure is a minus quantity, there is no excess profits tax and no necessity of a computation under the Invested Capital Method; moreover, the minus figure (less the \$5,000 specific exemption) may be carried forward to 1941 if the normal tax net income for 1941 is not more than \$25,000 (Code Sec. 710 (b) (3)).]

Excess profits tax:

First \$ 20,000 of above figure @ 25%	\$	.....	\$
Next 30,000 " " @ 30%		.....	\$
Next 50,000 " " @ 35%		.....	\$
Next 150,000 " " @ 40%		.....	\$
Next 250,000 " " @ 45%		.....	\$
Over 500,000 @ 50%		.....	\$
Total excess profits tax by Income Method ²		.....	\$

¹Similar to line 11 of Schedule B of 1939 Form 1120.
²Subject to the provisions of Code Secs. 721 and 722 regarding treatment of abnormal items.

**Schedule 1.—Adjustments to Normal Tax Net Income of Taxable Year (For Income Method)
(Code Sec. 711 (a) (1))**

Increase for long-term capital losses of taxable year.....	\$.....
Decrease for:	
Federal income and defense taxes for taxable year.....	\$.....
Long-term capital gains of taxable year.....	.....
Any excess of gains from sales or exchanges in taxable year of noncapital asset depreciable property held for more than 18 months, over losses from sales or exchanges of such property .....	.....
Income of taxable year from retirement or discharge of bonds, etc. ....	.....
AAA refunds and interest received in taxable year.....	.....
Bad debt recoveries of taxable year where deduction for such bad debts was allowable for any taxable year beginning prior to Jan. 1, 1940.....	.....
Balance of dividends received in excess of the 85% credit already reflected in normal tax net income.....	.....
<hr/>	
Resulting amount to be added to (if a plus total) or subtracted from (if a minus total) normal tax net income to derive excess profits tax net income.....	\$.....

Schedule 2.—Average Base Period Net Income¹ (For Income Method)

1936 normal tax net income ²	\$
Amount representing adjustments under Code Sec. 711 (b), which in many cases will be merely the 1936 income tax, including the surtax on undistributed profits	\$ [3]
<hr/>	
1937 normal tax net income ²	\$
Amount representing adjustments under Code Sec. 711 (b) .....	.....
<hr/>	
1938 special class net income ²	\$
Amount representing adjustments under Code Sec. 711 (b) .....	.....
<hr/>	
1939 special class net income ²	\$
Amount representing adjustments under Code Sec. 711 (b) .....	.....
<hr/>	
Average base period net income ($\frac{1}{4}$ of total of four items in last column) ³	\$ \$

¹Assuming that corporation reports on calendar year basis, is not affiliated with another company, and was in existence from January 1, 1936, to 1940. Building up a base period net income for corporations organized after January 1, 1936, and before January 1, 1940, is covered by Code Sec. 713(b)(5).

²Such income defined as "normal tax net income" under Code Sec. 13 (a) (2) [adjusted net income minus credit for dividends].
³If any one of the first four items in this column would be a minus quantity (loss for the year) it should be entered as zero; if more than one item would be a minus quantity, a zero should be entered for the largest minus quantity; the average for the four may not be less than zero. (Code Sec. 713(b).)

**Schedule 3.—Capital Changes During Year (For Income Method)
(Code Sec. 713 (c). Specific figures are used by way of illustration.)**

Daily capital additions:	
Money paid in for stock on February 5, 1940, \$20,000 × 330 ¹ days.....	\$6,600,000.00
Reduced for:	
Excluded capital: Municipal bonds purchased Mar. 4, 1940, for \$10,000 × 302 days.....	3,020,000.00
	\$3,580,000.00
Daily capital reductions:	
Distribution on Nov. 29, 1940, not out of earnings and profits, \$5,000 × 32 days.....	160,000.00
	\$3,420,000.00
Net daily capital addition.....	9,344.26
Dividing \$3,420,000.00 by 366 days in year.....	9,344.26
8% of \$9,344.26 = \$747.54, net capital addition during taxable year 1940.	

¹February 5 not counted, as new capital was not available at beginning of day.

**INVESTED CAPITAL METHOD
For Determining Excess Profits Tax Liability for 1940**

Normal tax net income for taxable year 1940 (Code Sec. 13 (a) (2)) ¹	\$.....
Adjustments under Code Sec. 711 (a) (2) as per Schedule 4.....	.....
Excess profits net income.....	\$.....
Average invested capital under Code Sec. 716 (from Schedule 5).....	\$.....
Less adjustment for inadmissibles (Code Sec. 720).....	.....
Invested capital (Code Sec. 715).....	\$.....
Excess profits credit (8% of above item).....	\$.....
Specific exemption (\$5,000).....	.....
Adjusted excess profits net income.....	\$.....
<u>Excess profits tax:</u>	
First \$ 20,000 of above figure @ 25%.....	\$.....
Next 30,000 " " @ 30%.....	\$.....
Next 50,000 " " @ 35%.....	\$.....
Next 150,000 " " @ 40%.....	\$.....
Next 250,000 " " @ 45%.....	\$.....
Over 500,000 " " @ 50%.....	\$.....
Total excess profits tax by Invested Capital Method ²	\$.....

¹ Similar to line 11 of Schedule B of 1939 Form 1120.

² Subject to the provisions of Code Secs. 721 and 722 re treatment of abnormal items.

Schedule 4.—Adjustments to Normal Tax Net Income (For Invested Capital Method)
(Code Sec. 711 (a) (2))

Increases

50% of interest representing interest on indebtedness included under Code Sec. 719 (a) in daily amounts of borrowed capital \$
 Interest on government bonds (Code Sec. 22(b) (4)) if it was excluded from gross income or allowed as credit against net income (optional increase in order to treat the bonds as admissibles)
Long-term capital losses.....

Total adjustment for increases.....

\$.....

Decreases

Federal income and defense taxes for taxable year 1940 \$
 Balance of dividends (other than on stock of foreign personal holding companies) received, in excess of 85% credit already reflected in normal tax net income
 Long-term capital gains
 Any excess of gains from sales or exchanges in taxable year of noncapital asset depreciable property held more than 18 months, over losses from sales or exchanges of such property
 Income from retirement or discharge of bonds, etc.
 AAA refunds and interest
 Bad debt recoveries where deduction for bad debts was allowable in taxable year prior to January 1, 1940

Total adjustment for decreases.....

\$.....

Total of adjustments to normal tax net income (plus figure if total increases are larger than total decreases; otherwise, a minus figure)..... \$

Schedule 5.—Average Invested Capital Under Code Secs. 716 to 719 (For Invested Capital Method)
(Specific figures are used by way of illustration. Short-cut method used)

Equity invested capital as of January 1, 1940:		
<i>Sum of:</i> Money previously paid in for stock or as paid-in surplus	.....	\$175,000.00
Property previously paid in for stock or paid-in surplus, valued as per Code Sec. 718 (a) (2)	.....	15,000.00
Statutory accumulated earnings and profits	.....	20,000.00
Gain on tax-free liquidation (Code Sec. 718 (a) (5) )	.....	9,000.00
		<u>\$219,000.00</u>
<i>Less:</i> Distribution in prior years not out of earnings and profits	.....	\$ 3,000.00
Earnings and profits of another corporation included in accumulated earnings by reason of a nontaxable exchange (Code Sec. 718 (a) (3) )	.....	5,000.00
		<u>8,000.00</u>
Total equity invested capital January 1, 1940	.....	<u>\$211,000.00</u>
Borrowed invested capital Jan. 1, 1940, \$25,000 (50% thereof as per Code Sec. 719 (b) )	.....	<u>12,500.00</u>
		<u>\$223,500.00</u>
Invested capital as of January 1, 1940	.....
Changes in invested capital during 1940:		
<i>Add:</i> July 1.—Proceeds of sale of additional preferred stock,		
\$46,000 × 183 days ¹	.....	\$8,418,000.00
<i>Deduct:</i> September 1 dividend paid out of prior year profits, \$5,000 × 121 days ¹	.....	\$605,000.00
October 15 loss from tax-free liquidation, \$10,000 × 77 days ¹ (Code Sec. 718 (b) (4) )	.....	770,000.00
		<u>\$1,375,000.00</u>
Aggregate daily reduction	.....
Net aggregate daily addition	.....	<u>\$7,043,000.00</u>
Net daily average addition (\$7,043,000 ÷ 366)	.....
Average invested capital for calendar year 1940	.....	<u>\$ 19,243.17</u>
		<u>\$242,743.17</u>

¹Date when transaction occurred not counted.