SUMMARY OF SENATE AMENDMENTS TO H. R. 4765

AN ACT TO AMEND THE CODE WITH RESPECT TO INCOME TAX TREATMENT OF CERTAIN DISTRIBUTIONS PURSUANT TO THE BANK HOLDING COMPANY ACT, AND FOR OTHER PURPOSES

---

prepared for the use of

THE HOUSE AND SENATE CONFEREES

by the

staff of the

JOINT COMMITTEE ON
INTERNAL REVENUE TAXATION

December 6, 1967

SUMMARY OF SENATE AMENDMENTS TO H. R. 4765

INCOME TAX TREATMENT OF CERTAIN DISTRIBUTIONS PURSUANT TO THE BANK HOLDING COMPANY ACT OF 1965

The bill as passed by the Senate modified the one provision contained in the bill as passed by the House and added five additional provisions. The provision in the House bill was modified by a floor amendment offered by Senator Williams of Delaware. Sections 2 through 5 were Senate Finance Committee amendments, although section 2 was modified by a floor amendment offered by Senator Williams of Delaware. Section 6 was a Senate floor amendment offered by Senator Nelson.

BANK HOLDING COMPANY DISTRIBUTIONS

(Sec. 1 of the bill)

This section of the bill provides special income tax treatment for certain distributions to shareholders made by corporations which were first classified as bank holding companies by the 1966 amendments to the Bank Holding Company Act of 1956. Under that Act, a bank holding company is not permitted to hold both banking and nonbanking interests. As a result of being classified as a bank holding company, the corporation must, therefore, divest itself of either its banking or nonbanking assets.

Special tax provisions were enacted in 1956 with respect to the distribution of property required as a result of the enactment of the Bank Holding Company Act of that year. This provision deals with a similar problem resulting from the 1966 amendments to the Bank Holding Company Act.

As passed by the House, no gain or loss would have been recognized to any shareholder on a distribution required by the Bank Holding Company law. The shareholders would have allocated the basis of their underlying stock between the stock received in the distribution and the underlying stock of the bank holding company which they retained, in the same manner as if the distribution had been an ordinary tax-free spin-off (sec. 355). This is substantially the same as the relief provided in 1956.

This provision, as reported by the Committee on Finance, was identical to the House version. However, this provision was amended on the floor of the Senate to apply a different set of rules. As passed by the Senate, this provision provides, as to distributions in conformity with the 1966 amendments, in the case of individual shareholders that capital gain will be recognized to them at the time of the distribution to the extent the fair market value of the property distributed exceeds the total cost or other basis the shareholders had for their bank holding company stock. This is the so-called DuPont-type treatment. For example, if the stock owned by a shareholder cost him $100 and he receives a distribution of stock having a fair market value of $70, no gain or loss will be recognized. (The stock received would have a basis of $70 and the stock retained would have a basis of $30.) On the other hand, if stock worth $70 is distributed and the stock originally owned cost $30, there will be a capital gain of $40 ($70 minus $30). (The stock received then would have a basis of $70, and the stock retained would have a basis of zero.)

Corporations will receive two different types of treatment depending upon whether or not they "elect" to have the bill apply.

A corporation which does not elect to have the bill apply will be taxed in the same manner as it would under present law in the case of any dividend in kind; that is, it will generally be taxed on 15 percent of the distributing corporation's cost or other basis for the stock distributed if this is less than fair market value. In the case of a personal holding company, this distribution would be treated as personal holding company income. If a corporation which has not elected to have the bill apply redistributes the stock to an individual shareholder, this will be treated as an ordinary dividend distribution to this shareholder.

A corporation electing the treatment under the bill will be taxed on 15 percent of the fair market value (instead of the cost or other basis) of the stock it receives. However, if the corporation redistributes the stock on down to individual shareholders, its shareholders will receive the same capital-gain-type treatment they would have received if the stock had been distributed to them directly by the bank holding company. In the case of a shareholder which is a personal holding company, the personal holding company income will be increased by the fair market value of the stock received.

MORTGAGE GUARANTEE INSURANCE

(Sec. 2 of the bill and secs. 381(c)(22), and 832 of the code, and sec. 26 of the Second Liberty Bond Act)

This amendment provides a deduction for income tax purposes for additions to a reserve for mortgage guarantee insurance losses of up to 50 percent of premiums earned during the year. In addition, the amount added to the reserve must be restored to income at the close of ten years. The deduction is not allowed, however, unless the company purchases a special issue of "tax and loss" Federal Government bonds in the amount of the tax benefit of the deduction. These bonds are to be noninterest bearing, nontransferable, and redeemable only when the amounts added to the reserve are restored to income. The bonds may be used to pay the income tax that results from the restoration to income of the amounts in the reserve. This provision, as amended on the Senate floor, applies only to taxable years beginning in 1967 and ending before 1968. The bill, as reported by the Senate Finance Committee, would have applied to all taxable years ending after 1966.

The amendment also provides special rules for additions made prior to 1967 to reserves for mortgage guarantee insurance losses. Tax and loss bonds are not required for these past years, but the additions to reserves made prior to 1967 must be included in income at the end of ten years following the year for which the addition was made. In addition, any losses incurred for taxable years beginning after 1966 to the extent that they exceed 35 percent of earned premiums for the year are to be charged to the pre-1967 reserve rather than against current income.

UNFUNDED PENSION PLANS OF EDUCATIONAL AND OTHER TAX-EXEMPT ORGANIZATIONS

(Sec. 3 of the bill and secs. 101, 403(b), 2039 and 2517 of the code)

Tax exemption with respect to unfunded plans.--This amendment extends special income estate and gift tax treatment to employees of universities and other organizations exempt from tax under section 501(c)(3) or State or local educational institutions with respect to unfunded pension plans of the organizations. This special tax treatment is the same as currently provided with respect to annuity contracts purchased by these employers for their employees.

In the case of the income tax change, up to $5,000 of payments made upon the employee's death may be treated as nontaxable even though the employee before death had a vested right to the amount if the amount was received within one year by reason of his death. For purposes of the estate tax, the value of the benefits under the plan is not included in the gross estate to the extent attributable to the employer's contributions. In the case of the gift tax, the exercise of an option by the employee converting an individual annuity into a joint and survivor annuity is not treated as a transfer subject to the gift tax to the extent of the value attributable to the employer's contribution.

This special tax treatment is provided only (1) with respect to retirement plans under which no amount is set aside to fund the benefits, (2) with respect to which the employee had the option to come under a comparable retirement plan funded by an annuity contract, and (3) with respect to which the Secretary of the Treasury has determined that the absence of funding does not materially jeopardize the ultimate payment of the benefits.

This provision applies to taxable years beginning after December 31, 1966, insofar as it relates to the income tax, to decedents dying after December 31, 1966, for estate tax purposes, and to transfers made after 1966 for gift tax purposes.

Revision in method of computing 20 percent limitation.--This amendment also modifies the exclusion allowance of present law used to determine amounts excludible from the income of an employee (of an educational institution and tax-exempt section 501(c)(3) organizations) under an annuity plan of an employer. In general, present law limits the amount excludible by an employee of these organizations under these special annuity plans to 20 percent of the employee's compensation on a cumulative basis. The amendment requires that the value of all retirement benefits provided by the employer forfeitable and nonforfeitable, funded and unfunded which were not includible in the gross income of the employee for any prior year be taken into account. This provision applies to taxable years beginning after December 31, 1967.

INVESTMENT CREDIT CARRYBACKS RESULTING FROM NET OPERATING LOSS CARRYBACKS

(Sec. 4 of the bill and secs. 46, 6411, 6501, 6511, 6601, and 6611 of the code)

This amendment repeals a provision of existing law which prevents the carryback to earlier taxable years of an unused investment credit which results from the carryback of a net operating loss. Under present law such an unused investment credit can only be carried forward to taxable years after the taxable year from which the unused credit arose.

The effect of this amendment is to grant to these unused investment credits (that is, those resulting from the carryback of net operating losses) the same carryback and carryforward period applicable to unused investment credits generally. The general rule is that unused investment credits can be carried back three years and forward seven.

Since limitations may have closed earlier years, this provision also amends present law to open these years for assessment and refund purposes. Under this provision, no interest will be paid for years prior to the year in which the net operating loss occurred. However, the amendment will not stop the running of interest on underpayments of income tax prior to the year in which the net operating loss arose. This amendment is to apply with respect to investment credit carrybacks attributable to net operating loss carrybacks from taxable years ending after July 31, 1967.

SPIN-OFF OF LIFE INSURANCE COMPANY

(Sec. 5 of the bill and sec. 815 of the code)

This amendment permits the spin-off (a distribution of a stock of a subsidiary by a corporation to its shareholders) by a life insurance company of the stock of a subsidiary life insurance company without the imposition of the phase III tax imposed by present law. In general, a phase III tax is imposed on a life insurance company when it distributes amounts to shareholders out of its "policyholders' surplus account." Additions to this account are not taxed to a life insurance company at the time they are made. The provision applies only if the distributing corporation at all times since December 31, 1957, owned 80 percent or more of the stock of the subsidiary being spun off. The amendment provides

that to the extent contributions to capital were made after December 31, 1957, the amount contributed is to be subject to the phase III tax upon the spin-off. The amendment applies to distributions made after December 31, 1966.

CARRYBACK AND CARRYFORWARD PERIOD FOR NET OPERATING LOSSES IN CERTAIN CASES

(Sec. 6 of the bill and sec. 172 of the code)

Under present law, a corporation may carry its net operating losses back three years and then forward five years. A Senate floor amendment (by Senator Nelson) reverses this in specified situations to permit net operating losses to be carried back five years and forward three. This special rule will apply only if--

(1) the taxpayer's loss for the taxable year exceeds the sum of the taxable income for the three preceding taxable years,

(2) the taxpayer's total net operating loss for the taxable year and for the preceding taxable year exceeds 15 percent of all its money and property (taking property into account at its adjusted basis for determining gain),

(3) the total unadjusted basis of business property acquired during the 5-year period ending on the last day of the loss year is greater than the total of the unadjusted basis of the business property owned on the first day of such 5-year period, and

(4) the taxpayer derives 50 percent or more of its gross receipts from the manufacturer of a single class of products and three or fewer U. S. persons (other than the taxpayer) manufacture in the United States more than 85 percent of all units within such class in the calendar year ending in or with the taxable year of the loss.

The amendment applies to net operating losses sustained in taxable years ending after December 31, 1966.