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TAX REFORM BILL OF 1974

Tentative Decisions of the Ways and Means Committee
Corresponding to Sections of Draft Bill

PREPARED FOR THE USE OF

THE COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

BY

THE STAFF

OF THE

JOINT COMMITTEE ON INTERNAL
REVENUE TAXATION

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TITLE I—CHANGES PRIMARILY AFFECTING INDIVIDUALS

Part 1—Changes in Deductions, Credits, and Exclusions

Sec. 101. Deductions for expenses attributable to business use of homes, rental of vacation homes, etc.

Business Use of Home

The committee agreed to provide definitive rules for deductions of expenses attributable to the use of a taxpayer's home for business purposes. In general, a taxpayer will not be permitted to deduct any expenses attributable to the use of his home for business purposes. The committee, however, provided for certain situations in which deductions for such expenses will be permitted. A deduction will be permitted if a portion of the home is used exclusively on a regular basis as:

(1) The taxpayer's principal place of business; or

(2) A place of business which is used by patients, clients, or customers in meeting or dealing with the taxpayer in the normal course of business.

In the case of an employee, the business use must be for the convenience of the employer.

A special rule will be provided to cover situations where self-employed individuals may use their home for trade or business purposes on a regular basis but do not use a specific portion of their home exclusively for such purposes. This rule would cover the situations where a trade or business is actively conducted by a taxpayer in his home and is not conducted at any other location. In this case, a deduction for the allocable expenses will be permitted but is not to exceed the income generated by the business activities of the taxpayer in his home.

The deductions attributable to the rental of a portion of a taxpayer's home will be subject to the same limitations that will apply to vacation homes.

Vacation Home

Under present law, section 183 of the Internal Revenue Code provides that if an activity is not engaged in for profit, the amount of the allowable trade or business deductions, (such as depreciation, maintenance, and utilities) cannot exceed the amount of the gross income derived from the activity less the related personal deductions such as interest and taxes. The determination of whether an activity is engaged in for profit is made by reference to objective standards taking into account all the facts and circumstances of each case. There is a presumption that a taxpayer is engaged in an activity for profit if in two of the five preceding taxable years the activity actually produced a profit.

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This provision was enacted as part of the Tax Reform Act of 1969, and among the activities it was intended to cover was the rental of vacation homes used for personal purposes. Since the rules and regulations do not provide definitive rules in the case of vacation homes used for personal purposes, the committee agreed to provide more specific rules.

If a vacation home is used by a taxpayer for personal purposes for more than two weeks and 5 percent of the actual business use (that is, its actual rental time), then deductions will be subject to a limitation whether or not the presumption under present law would otherwise apply. This means that the allocable deductions for trade or business or the production of income relating to the vacation home, which would be allowed if the activity were engaged in for profit, are not to exceed the gross income from the business use of the vacation home.

If the vacation home is used for less than two weeks or less than 5 percent of the actual business use, then the new provision will not apply.

These special rules will not apply if the vacation home results in a profit for the year or if there is no personal use of the vacation home during the year.

Where there is any personal use of a vaction home, the deductions allowable for rental activities will be limited to the actual rental use divided by the total actual use of the property (that is, the business use and personal use) times the expenses attributable to the vacation home other than expenses which are deductible in any event.

Sec. 102. Deductions for conventions, etc., outside the North American area.

The committee agreed to limit deductions allowable for the expenses of taxpayers attending conventions, educational seminars or similar meetings outside North America. The general rule agreed to by the committee is that no deduction is allowable for foreign travel expenses (including expenses for transportation, meals and lodging) for an individual with respect to a convention, seminar or similar meeting held outside North America unless, taking into account certain factors, it is more reasonable to hold the meeting outside the North American area. North America is defined to include the Caribbean.

This rule will not apply to a meeting conducted by an organization which draws from foreign members to the extent the number and location of its foreign meetings are reasonable in light of the number of foreign members and their geographical dispersion. Present law relating to the allocation of expenses will continue to apply in any case where the travel expenses attributable to foreign meetings may still be deductible.

This rule also is not intended to apply to the expenses incurred in attending a convention, etc., at a location that is uniquely suited to the purposes of the convention, provided that the attendance at the conference by an individual is related to his trade or business. Thus, a deduction will be allowed in the case of an individual who attends a meeting conducted or sponsored by a domestic organization which meets outside North America if there is a compelling reason for meeting outside, taking into account the membership and purpose of the organization.

Sec. 103. Tax credit for home garden tool expenses.

The committee agreed to provide a 7-percent investment tax credit to individuals for the purchase of home garden tools used in the production of home vegetable gardens. The credit is to be available on purchases of equipment up to $100 a year ($50 in the case of a husband or wife filing a separate return).

Sec. 104. Revision of retirement income credit.

The committee decided to restructure the present retirement income credit and convert it to a tax credit for the elderly, available to all taxpayers age 65 or over regardless of whether they have retirement income or earned income. The maximum amount on which the credit is computed is increased to $2,500 for single persons age 65 or over (or for married couples filing joint returns where only one spouse is age 65 or over) and to $3,750 for married couples filing joint returns where both spouses are age 65 or over. Under present law, the maximum amount on which a credit is computed in the case of a single person is $1,524; for a married couple, the maximum amount is $2,286 in the case of one "retirement income" recipient and $3,048 in the case of two recipients.

These maximum amounts for computing the credit are reduced under present law by social security benefits and other exempt pension income. Present law also reduces the credit by one-half the earnings over $1,200 and under $1,700, and by all the earnings over $1,700. The committee decided to eliminate this earnings cut-back (but not the cutback for social security benefits and other tax-exempt pension income) and provide an income phaseout based on adjusted gross income (rather than just earned income) above $7,500 for single persons and $10,000 for married couples to limit the benefits of the credit to low- and middle-income elderly taxpayers. Under this phaseout the maximum amount on which the credit is computed is reduced by $1 for each $2 of adjusted gross income (AGI) above the indicated AGI levels.

The committee also agreed to eliminate the provisions of present law that limit the credit based on the amount of a taxpayer's retirement income; thus, the credit will also be allowed for earned income.

In addition, the committee agreed to eliminate the requirement that to be eligible for the credit, the taxpayer must have met the test of earning $600 a year for 10 years. Further, the variation in treatment of married couples depending on whether they are separately eligible for the credit is eliminated.

The committee raised the maximum amount on which the credit may be computed in the case of individuals under 65 who receive public retirement pensions to $2,500 for single persons and $3,750 for married couples. It also eliminated for people under 65 the 10-year, $600 earnings requirement and the variation in treatment of married couples.

Sec. 105. Changes in exclusions for sick pay and certain military, etc., disability pensions.

The temporary sick pay exclusion is to be repealed generally. The exclusion for disability income is to continue to be available to taxpayers under age 65 who are permanently and totally disabled (After that age they will be eligible for the revised elderly credit.)

The maximum amount of income that may be excluded as disability income in this case, as under the present law, sick pay exclusion, is limited to $100 a week ($5,200 a year). The maximum amount excludable is reduced on a dollar-for-dollar basis by the taxpayer's income (including the disability income) in excess of $5,200. For this purpose, permanently and totally disabled means unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months. These limitations are applicable to both military and civilian retirement disability payments but not to payments by the Veterans' Administration.

Sec. 106. Child care deduction.

The child care deduction is to be revised to broaden the overall application of the provision and to simplify it. The deduction for child (or disabled dependent) care expenses is extended to married couples where the husband or wife, or both, work part-time. (Presently both spouses are required to work full time.) The deduction is limited to the amount of earnings of the spouse earning the smaller amount, or in the case of a single person, to his earnings. The deduction is also made available in the case of married couples where one is a full-time student and the other spouse works. Also, the income level at which the deduction starts to phase out will be raised from $18,000 to $30,000.

Additional child care changes include eliminating the distinction between care in the home and care outside the home, making the deduction available to a divorced or separated parent who has custody of a child even though not entitled to a dependency exemption for the child, and making a deserted spouse eligible for the deduction where the deserting spouse is absent for more than 6 months rather than an entire year.

Several changes were also agreed to by the committee to simplify the tax return form by eliminating the need for a separate child care schedule. One such change replaces the present monthly maximum deduction ($200 for one dependent, $300 for two dependents, and $400 for three dependents) with a maximum annual deduction of $2,400 for one dependent and $4,800 for two or more dependents. Finally, the requirement that the deduction for the taxpayer be reduced by disability income received by his dependent is eliminated.

Sec. 107. Deduction for alimony allowed in determining adjusted gross income.

The deduction of alimony payments is to be moved from an itemized deduction to a deduction from gross income to arrive at adjusted gross income.

Sec. 108. Revision of deduction for medical, dental, etc. expenses.

The deduction for one-half of medical insurance premiums (up to $150) which is allowable without regard to the 3-percent floor applicable to other medical expenses is to be repealed.

The 3-percent floor applicable to the medical expense deduction is to be increased to 5 percent, and the 1-percent floor with respect to drugs is to be eliminated. Expenses for drugs will be covered under the 5-percent floor but the deduction will apply only to prescription drugs.

Sec. 109. Limitations on casualty losses.

The casualty loss deduction is to be subject to a 3-percent of AGI floor, but casualty losses in excess of $50 per loss (instead of $100 as under present law) are to be taken into account for the floor.

Sec. 110. Treatment of losses from certain nonbusiness guaranties.

The committee agreed to provide the same treatment for a noncorporate guarantor (or endorser or indemnitor) of certain noncorporate obligations as is presently provided in the case of a person who makes a direct loan to a principal debtor who uses the loan in a trade or business. Under present law, a noncorporate guarantor of certain noncorporate obligations is allowed business bad debt treatment on any payment made by him in discharge of all or part of his obligation as guarantor. Business bad debt treatment allows the guarantor to claim an ordinary loss deduction rather than a short-term capital loss deduction, which would be the case if the guarantor had made a direct loan which was defaulted instead of guaranteeing the loan.

The committee agreed to eliminate the provision that allows noncorporate guarantors to treat as business bad debts the losses from a guarantee of certain noncorporate obligations. This would mean that the losses of noncorporate guarantors would be considered nonbusiness bad debts and treated as short-term capital losses. In addition, the committee decided to make it clear that in all respects where a taxpayer has a loss arising from a guarantee of a loan, he is to receive the same treatment as where he has a loss from a loan which he makes directly.

Sec. 111. $200 deductible in case of trade or business expenses of employee or expenses of activity engaged in for profit.

The deduction for miscellaneous expenses (which includes employee business expenses and expenses for the production of income) is to be continued, but a $200 floor is provided so that only the total miscellaneous expenses above $200 are to be deducted.

Sec. 112. Repeal of dividends received exclusion.

The dividend exclusion is to be repealed.

Sec. 113. Repeal of deduction for State and local taxes on gasoline and other motor fuels.

The deduction for State gasoline taxes is to be repealed.

Sec. 114. Elimination of deduction for certain property transfer taxes.

The deduction for State or local property transfer taxes is to be repealed.

Sec. 115. Elimination of deduction for certain disability, etc., taxes.

The deduction for State disability and unemployment compensation taxes is to be repealed.

Sec. 116. Revision of tax tables for individuals.

The committee agreed to revise the tax tables published by the Internal Revenue Service. Under present law, taxpayers having adjusted gross income of less than $10,000 and not itemizing deductions must use the optional tax tables provided by the IRS. (Individuals who itemize deductions or have adjusted gross income in excess of $10,000 must use the rate schedules.) These twelve tax tables, take up 6 pages of instruction and taxpayer's often use the wrong table. For simplification, the committee agreed to base the tax tables on taxable income rather than adjusted gross income and to extend their applicability to taxable incomes up to $20,000. Thus, all taxpayers with taxable incomes of less than $20,000 will compute their taxable income by subtracting the amount of their personal exemptions and deductions from their income and then by looking up their tax in the tables. These tables will be much simpler to use and be more generally applicable than the present tax tables.

Sec. 117. Cost of living adjustment for certain section 162 amounts.

The committee agreed to update the $3,000 limitation which was imposed in 1952 upon deductible away-from-home living expenses for a Member of Congress. (The tax home of a Member of Congress is considered to be his place of residence within the State or congressional district which he represents). The committee agreed to increase the amount of the limitation, effective January 1, 1975, on the basis of changes in the most recent Consumer Price Index for the District of Columbia at the beginning of each new Congress. This adjustment is to reflect the cost-of-living increases that have occurred since 1952, when the present dollar amount was established.

Sec. 118. Cancellation of indebtedness with respect to certain student loan programs.

To permit a review of policy, the committee agreed to exclude from income cancellations of indebtedness from government-sponsored student loan programs that occur before 1976.

Part II—Simplification Deduction and Other Decreases in Tax Attributable to Simplification

Sec. 121. Simplification deduction.

To replace itemized deductions eliminated by the previous committee decisions concerning simplification, a "simplification deduction" is provided to taxpayers who itemize their deductions. This special simplification deduction would be taken in addition to a taxpayer's other itemized deductions and is equal to $350 plus 2 percent of adjusted gross income, up to a maximum of $650.

Sec. 122. Increase in percentage standard deduction.

The standard deduction under present law of 15 percent of adjusted gross income with a maximum of $2,000 is increased to 17 percent with a maximum of $2,500.

Sec. 123. Increase in low-income allowance.

The present low income allowance of $1,300 is increased to $1,400 for single taxpayers and $1,500 for married couples filing joint returns.

Sec. 124. Changes in withholding tables to reflect increase in percentage standard deduction and increase in low-income allowance.

The changes in the standard deduction and low income allowance are to be reflected in income tax withholding beginning in January 1975.

Part III—Minimum Tax; Limitation on Artificial Losses; Related Amendments

Sec. 131. Minimum tax for individuals.

The committee decided to replace the existing minimum tax applicable to individuals with a new minimum tax. The existing minimum tax is an addition to the regular income tax. The new minimum tax for individuals will be an alternative to the regular income tax, and individuals will pay this tax only if it exceeds their regular tax.

The base of the minimum tax will be "economic income" less an exemption and certain deductions. "Economic income" is adjusted gross income, as defined under present law, plus most of the existing items of tax preference (the exceptions are rapid amortization of railroad rolling stock, accelerated depreciation on personal property subject to a net lease, and accelerated depreciation both on buildings covered under the limitation on artificial losses and on low-income housing subsidized under Federal, State or local government programs.) Deductions allowed against economic income will be investment interest and expense to the extent of investment income, extraordinary medical expenses and casualty losses, and charitable contributions. The basic exemption will be $20,000, but it will be reduced dollar for dollar as economic income less deductions rises above $20,000, so that the exemption will be phased out entirely when the excess of economic income over deductions equals $40,000.

The minimum tax rate will be one-half the regular tax rates on an equivalent amount of taxable income.

Sec. 132. Limitation on artificial losses.

A. Farm losses

The committee decided to impose a limitation on the extent to which artificial losses from farm operations can be used by individuals to offset income from nonfarm sources. The limitation is to apply in the case of the deductions for (a) prepaid supplies consumed in a later period (such as feed or fertilizer) and (b) preproductive period expenditures not treated as capital items which are incurred during the development period in the case of orchards, vineyards, and similar farming operations (but not including expenses incurred in connection with the breeding or feeding of livestock before reaching the productive stage). The limitation on preproductive period expenditures will not apply if the preproductive period is less than one year. Expenses deductions may in any event be offset against farm income. In addition, they may also be offset against nonfarm income where the taxpayer has $20,000 or less of this nonfarm income. If a taxpayer has nonfarm income over $20,000, artificial deductions of the type referred to above in excess of farm income which may be deducted currently against other income are to be reduced from the level of $20,000, on a dollar for dollar basis, for each dollar of nonfarm income of the taxpayer in excess of $20,000. This means that no artificial deductions in excess of farm income can be taken as deductions currently by taxpayers with nonfarm income over $40,000. To the extent deductions may not be taken currently under this provision, they may be taken in subsequent years to the extent of farm income.

B. Production of movies

The committee decided to apply the LAL provision to deductions for depreciation with respect to investments by individuals in motion pictures and similar productions. Under the provision adopted by the Committee, a taxpayer could not take a current tax deduction for these deductions for depreciation to the extent they exceed his income from investments in motion pictures and similar productions. Deductions which cannot be taken currently are set aside in a deferred deduction account and are deductible in later years when the taxpayer receives income from these investments. This rule will not apply for films where production is begun before June 30, 1975.

C. Personal property subject to a net lease

The committee agreed to apply LAL to accelerated depreciation and amortization on personal property subject to a net lease. Deductions for the excess of accelerated over straight-line depreciation for each such property will be limited to the income from the property, and excess deductions will be deferred to future years. This is to apply after December 31, 1974, for leases entered into after September 17, 1974.

D. Real estate

The committee also decided to apply LAL to real estate. The excess of accelerated over straight-line depreciation and interest and taxes attributable to the construction period of a building will be allowed as a deduction only against income from real estate (with all properties treated on a consolidated basis). Excess deductions that are not permitted for a year will be suspended and offset against related income in future years. Generally, LAL will apply to commercial property constructed after December 31, 1975, and to residential property constructed after December 31, 1977. The application of LAL to construction period interest and taxes on commercial real estate will be phased in between 1976 and 1978; and its application to construction period interest and taxes on residential real estate will be phased in between 1978 and 1980. Low-income housing built under various Federal, State and local government subsidy programs will be permanently exempted from LAL.

Sec. 133. Method of accounting for corporations engaged in farming.

The committee decided that corporations carrying on farming operations, other than subchapter S corporations and family corporations, are for tax purposes to be required to use accrual and inventory accounting methods for their farm operations. A family corporation for this purpose is defined as one where at least 75 percent of the voting stock and 75 percent of the total stock in a corporation are owned by a single family, including brothers and sisters, spouses, ancestors and lineal descendants, an estate of any of these family members and trusts for the benefit of such family members. A corporation electing the exception under this provision will be subject to the LAL rules on farm losses.

Sec. 134. Repeal of farm excess deductions account.

Because farm losses are included in the limitation on artificial losses, the committee agreed to repeal the provisions relating to farm excess deductions accounts.

Sec. 135. Limitation of loss with respect to motion picture films and livestock enterprises to the amount for which the taxpayer is a risk.

In the case of investments in motion pictures and similar productions, the committee decided to limit the deduction of losses to the investments "at risk," excluding all nonrecourse loans. This rule will not apply for films where production is begun before June 30, 1975.

In this case of feeder cattle and other livestock used for breeding, draft, dairy, or sporting purposes, deductions for losses are not to be allowed in excess of the amount of capital or credit of the individual which is "at risk" in the venture. For this purpose, a taxpayer will not be considered "at risk" in the case of a nonrecourse loan or to the extent the taxpayer has a right to be reimbursed for any loss on the investment such as by reason of a "stop loss" order, a guaranteed repurchase agreement, insurance or other similar arrangement.

Sec. 136. Limitation on deduction of intangible drilling costs to amount for which the taxpayer is at risk.

The committee decided to add a provision that limits the deduction of intangible drilling and development costs on a property to the amount for which the taxpayer is at risk with respect to that property.

Sec. 137. Treatment of prepaid interest.

The committee decided to require use of the accrual method to account for prepaid interest properly allocable to the period after the close of the taxable year. As an exception to this general rule, however, prepaid interest which is properly allocable to the 12-month period following the year in which it is paid can be deducted in the year in which paid to the extent of the net income for that year from the property to which the interest relates.

Sec. 138. Clarification of treatment of partnership syndication fees, etc.

The committee decided to make it clear that partnership syndication fees are to be capitalized.

Sec. 139. Recapture of depreciation on real property.

In the case of real estate, the committee decided to provide for the complete recapture of all depreciation in excess of straight-line depreciation to the extent of any gain involved at the time of the sale of the property. (This rule already applies in the case of commercial property.) However, in the case of low-income housing assisted under

Federal, State or local law, the depreciation in excess of straight-line to be recaptured would be reduced by one percentage point for each full month the property is held after the date on which the property was held 100 full months (20 full months if the property was acquired or construction thereof began before January 1, 1978).

Sec. 140. Application of class life system to real property.

Present law makes provision, after 1973, for the application of the class life system (sometimes referred to as the asset depreciation range or ADR provision) to real estate. The committee deleted this provision.

Part IV—Capital Gains and Losses

Sec. 141. Increase in amount of ordinary income against which capital losses may be offset from $1,000 to $3,000.

The committee agreed to increase the amount of ordinary income against which net capital losses can be deducted from $1,000 to $3,000. This will apply both to capital losses incurred in 1974 and in future years and to existing carryovers from prior years. The carryforward of losses from pre-1969 years will be treated in the same manner as those from later years.

Sec. 142. Individuals may elect 3-year carryback of capital losses.

The committee also decided to give individuals with losses in excess of $30,000 (excluding losses incurred in a year and carryforwards into the year) the option of electing a three-year carryback of capital losses against capital gains (but not against ordinary income). Individuals who use the carryback option would have to recompute their tax for the prior years to which the losses are carried back.

Sec. 143. Increase in wash sale period from 30 to 60 days.

In connection with carryback option the committee decided to extend to 60 days the period in which purchases and sales of the same asset would be considered wash sales.

Sec. 144. Increase in holding period required for capital gain or loss to be long-term.

The committee decided to increase the holding period that defines short-term capital gains from six months to one year. The increase would be phased in over a three-year period starting January 1, 1975, so that the holding period would be eight months in 1975, ten months in 1976, and one year thereafter.

Sec. 145. Increase in amount of capital gain deduction for certain assets held for long periods.

The committee decided to provide, in addition to the present 50-percent exclusion for long-term capital gains, a second exclusion equal to one percent of the taxpayer's gain for each asset for each year the asset is held in excess of five years. The additional deduction will be limited to 20 percent of the gain on each asset (after twenty-five years) and to not more than 75 percent of the taxpayer's overall net capital gain. The additional exclusion will apply only in the case of sales or exchanges of securities, businesses and real estate. It will be effective for all such sales on and after July 1, 1974.

Sec. 146. Repeal of alternative tax for individuals.

The committee decided to eliminate the 25 percent alternative tax rate for the first $50,000 of capital gains.

Sec. 147. Section 1245 property excluded from section 1231.

The committee decided to require that gains on depreciable personal property which are currently treated as long-term capital gains under section 1231 (not including gains referred to in section 1231(b) (2) and (3)), and to which the recapture rules of section 1245 apply, be treated as ordinary income.

Sec. 148. Exclusion from gross income of gain from sale of residence.

Under existing law, an individual over 65 who sells a property that he had used as his principal residence for five or more years out of the past eight years can exclude his whole capital gain if the sales price is less than $20,000. When the sales price exceeds $20,000, he can exclude a fraction of the gain equal to the ratio of $20,000 to the sales price. The Committee decided to extend this exclusion to all individuals regardless of age and to increase the $20,000 figure to $35,000. Under the decision, when the sales price of a principal residence exceeds $35,000, the seller can exclude a fraction of the gain equal to $35,000 divided by the sales price. This exclusion will be available only if the rollover provision under section 1034 is not elected.

Sec. 149. Extension of period for replacing old residence for purposes of nonrecognition of gain under section 1034.

Under existing law, an individual who sells his principal residence and reinvests the proceeds in a second principal residence within one year (before or after the sale) can defer tax on his capital gain until he sells the second residence. In the case of a new residence, the period in which the purchase can be made without gain being recognized is one year before and 18 months after the sale of the former principal residence. The committee decided to increase the one-year period to 18 months and the 18-month period to 2 years. This is expected to have no appreciable revenue effect, but it will provide relief in cases where an individual is prevented from moving into his new residence for some reason beyond his control.

Sec. 150. Change in tax treatment of qualified stock options.

The committee agreed to modify the tax treatment with respect to qualified stock options. Under present law, a qualified stock option is not treated as income when it is granted or when it is exercised. In addition, when the stock acquired under the option is sold or exchanged by the employee, the difference between the option price and the price received by the employee is generally treated as long-term capital gain or loss.

The committee revised this treatment, so that in the future, qualified stock options will be subject to the rules of section 83 of the Internal Revenue Code (which applies today in the case of most nonqualified options granted after June 1969). Generally, the value of the option would constitute ordinary income to the employee if it had a readily ascertainable fair market value at the time it was granted (and was not nontransferable and subject to a substantial risk of forfeiture), If the option did not have a readily ascertainable value, it would not constitute ordinary income at the time it was granted, but when the option was exercised the spread between the option price and the value of the stock would constitute ordinary income to the employee.

In general, the new rules are to apply to options granted after May 8, 1974, but are not to apply to options granted on or before this date. This is true even though the option is exercised in the future (so long as it meets the terms of the present rules of a qualified option). In addition, the committee agreed to include transition rules for options granted after May 8, 1974, pursuant to a written plan adopted and approved before May 9, 1974; for options granted after May 8, 1974, under a qualified plan adopted by a board of directors before May 9, 1974, even if the plan was approved by the shareholders after that date; and for substitute options granted after May 8, 1974, as a result of a corporate reorganization or similar transaction provided that no modification of the former option occurs. The transition rules cover these options as long as they are exercised before May 9, 1979 (no matter when the option is granted in accordance with the plan).

The committee did not revise the rules with respect to employee stock purchase plans which provide that stock under the plan must be made available to all the employees of a corporation on a nondiscriminatory basis.

Sec. 151. Gain from condemnation of certain forest lands held in trust for the Klamath Indian Tribe excluded from gross income.

The committee decided to allow members of the Klamath Indian Tribe to exclude from gross income their capital gain on the sale of their tribal land under condemnation proceedings.

Part V—Accumulation Trusts

Sec. 156. Accumulation trusts.

For the two alternative methods used in computing the throwback rule for accumulation distributions, the committee agreed to substitute a single method, a revision of the present "short cut method." This method will throw back the average accumulation distributions (as determined under present law) to the 5 preceding years of the beneficiary (rather than the 3 preceding years under present law). This average amount will be added to the beneficiary's taxable income for these years (rather than requiring the recomputation of his tax returns as under present law). Of these 5 preceding years, the year with the highest expanded taxable income and the year with the lowest will not be considered; in effect, then, the computation of the additional tax on the accumulation distribution under this short cut method will continue to be based on a 3-year average basis. In other respects generally, the present rules under the short cut method will continue to be applicable, except that no refunds will be available.

Income accumulated by a trust prior to the beneficiary's attaining the age of 21 and the years a beneficiary was not in existence will not be subject to the throwback rule (except in the case of distributions from multiple trusts, as described below).

A special rule is provided for 3 or more trusts which accumulate income in the same year for a beneficiary.

The capital gains throwback rule is to be repealed. A special rule is provided to cover the possible tax abuse where the grantor places in trust property which has unrealized appreciation in order to shift the payment of any capital gains tax to the trust at its lower progressive rate structure.

These changes are to apply to accumulation distributions made in taxable years beginning after December 31, 1973.

TITLE II—CHANGES PRIMARILY AFFECTING CORPORATIONS

Part I—Tax Treatment of Small Business

Sec. 211. Changes in additional first-year depreciation allowance for small business.

With respect to the additional first-year depreciation allowance, the committee agreed to:

a. increase the dollar limit on the amount of property which may qualify for the allowance from $10,000 to $15,000 ($30,000 on a joint return); and

b. eliminate the requirement that the property eligible for the allowance have a useful life of 6 years or more.

Sec. 212. Increase in minimum accumulated earnings credit from $100,000 to $150,000.

The amount of earnings a corporation may accumulate without the imposition of the accumulated earnings tax is to be increased from $100,000 to $150,000.

Sec. 213. 10-year carryover of net operating losses incurred during first 10 years of operation.

In the case of new businesses, the period over which net operating losses may be carried is to be increased from 5 years to 10 years during the first 10 years of operation.

Sec. 214. Closing of partnership taxable year on death of partner.

The successor in interest of a deceased partner may elect to close the taxable year of the partnership with respect to the interest of the deceased partner as of the date of his death, instead of waiting until the close of the partnership taxable year or the date his interest is sold, exchanged, or liquidated.

Sec. 215. Changes in provisions relating to subchapter S corporations.

The committee also agreed to four changes dealing with subchapter S (the election of certain small business corporations not to be taxed as corporations). These tentative decisions are as follows:

a. Increase in number of shareholders.—The maximum number of shareholders which a subchapter S corporation may have is to be increased from 10 to 15.

b. Certain trust ownership.—In three types of situations trusts will be permitted to be qualified shareholders in subchapter S corporations: in the case of (1) voting trusts; (2) grantor trusts (where the grantor is treated as the owner for tax purposes); and (3) instances where the holding by the trust is only temporary (e.g., where it passes through a residuary trust to individual beneficiaries).

c. Estate of deceased spouse not to be treated as shareholder.—When subchapter S stock has been held by a husband and wife, the estate of one of the spouses will not be considered a shareholder for purposes of determining the number of shareholders of the subchapter S corporation.

d. New shareholders must affirmatively elect to terminate election.—A subchapter S election is to be terminated only upon a new shareholder's affirmative refusal to consent to a continuation of the subchapter S election (instead of upon the failure of a new shareholder to consent to the election).

Part II—Certain Accounting Changes

Sec. 221. Accrual of vacation pay.

A permanent solution for the treatment of accrued vacation pay is provided to allow an employer to take a deduction in the case of accrued vacation pay which, except for contingencies (such as termination of employment before vacation time arrives), has already been earned by the employees. However, to prevent a doubling up of deductions in the case of an employer who is not covered by the provisions relating to accrued vacation pay in the Technical Amendments Act of 1958, if the employer elects to take deductions under this new provision for accrued vacation pay, he may not currently take a deduction for payments of the contingent amounts which accrued (on this basis) in years prior to the year in which the employer elects this treatment. This amount is held in suspense and is available as a deduction only to the extent that the end of the year liability for accrued vacation pay (on the new basis) is less than the beginning amount held in the suspense account.

These provisions are effective for taxable years beginning after January 1, 1973.

Sec. 222. Income attributable to magazines which are returned.

Magazine publishers often distribute to retail distributors more copies of a magazine than is anticipated the retailer can sell to assure them an adequate number of copies for display purposes. When the next issue of the magazine is distributed to the retailer, the retailer will return the unsold copies of the magazine (or parts of them) to the publisher.

The committee agreed to allow an adjustment in a taxable year for magazines distributed in that year which were returned to the publisher in the succeeding year. The provision would allow the adjustment to be made only for the returns actually made or returns the taxpayer knows have been made within 75 days after the end of the year. This provision is to apply after the date of enactment of the bill and is not intended to infer what constitutes the proper treatment under present law.

Sec. 223. Tax treatment of installment obligations disposed of to a life insurance company.

The committee agreed to modify the rule in present law that if installment obligations are transferred to a life insurance company, the nonrecognition provisions of the Code are not to apply and the transferor is to be taxed on the unrecognized gain on the installment obligations.

The committee also agreed to a conforming change to make it clear that the installment obligation income is to be subject to tax to the life insurance company as taxable investment income (or as long-term capital gain).

Sec. 224. Tax treatment of face-amount certificates.

Presently, the Internal Revenue Service regulations require that in the case of a face-amount certificate issued by a corporation after December 31, 1974, the amount of any original issue discount attributable to the certificate must be included in the gross income of the holder on a pro rata basis over the life of the certificate. According to the regulations, the amount that must be ratably included in gross income is the difference between the amount paid for the certificate by the purchaser and the amount received by him at maurity.

The committee decided that in the case of a face-amount certificate issued by a corporation, the amount of any discount is to be included in the taxpayer's gross income only at the time of sale, exchange, or other disposition of the certificate (or redemption by the issuer).

Part III—Amortization

Sec. 231. Extension of period during which pollution control facilities, railroad rolling stock, rehabilitation of housing, and coal mine safety equipment may qualify for 5-year amortization.

The committee agreed to extend four provisions that provide 60-month amortization beyond their present December 31, 1974, expiration date. These provisions were included in the Tax Reform Act of 1969 for certain activities because the investment tax credit was repealed in that Act. Rapid amortization is not available, however, if the taxpayer takes the reenacted investment tax credit (except in the case of certain railroad property).

The committee extended for 3 more years (to December 31, 1977) the rapid amortization provisions for rehabilitation of low income rental housing (sec. 167(k)) and certified pollution control facilities (sec. 169) installed in a plant that was in operation before January 1, 1974. An extension for 2 more years (to December 31, 1976) was agreed to for coal mine safety equipment (sec. 187). Rapid amortization for railroad locomotives and freight cars (sec. 184) was extended for 5 years (to December 31, 1979).

Sec. 232. Certain changes in amortization provisions.

The committee agreed to increase the amount of expenditures that can be taken into account with respect to a low-income rental housing unit for purposes of the rapid amortization provision from $15,000 to $20,000.

Sec. 233. Amortization over 50-year period of railroad grading and tunnel bores placed in service before 1969.

Railroad grading and tunnel bores that were placed in service before 1969 may be amortized over a 50-year period. This provision is available to domestic railroad common carriers at their election. A similar provision was enacted in the Tax Reform Act of 1969 but covered only railroad grading and tunnel bores placed in service after 1968.

Sec. 234. Amortization of certain railroad equipment.

Expenditures for the construction, installation, or erection of electronic classification yards, equipment for handling trailers and containers, communications and signal equipment, and improvements and betterments in railroads' track accounts will be eligible for 60-month amortization. This provision is in addition to the 60-month amortization for locomotives and freight cars.

Sec. 235. Amortization of expenditures in connection with literary, historical, etc., projects.

The committee agreed to add a new 5-year amortization provision for certain expenses in connection with a literary, historical or similar project. These are expenses which are paid or incurred in connection with a trade or business and are chargeable to capital account but not chargeable to property which is depreciable other than the copyright or other product resulting from the project. The amortization deductions, however, will be limited to the taxpayer's net income from the project.

Part IV—Investment Credit

Sec. 241. Increase in investment credit for public utilities.

The committee agreed to raise the investment credit for public utilities from 4 to 7 percent. For a controlled group of telephone companies, however, the additional three percentage points is limited to $25 million of investment credit each year.

Present law limits the amount of the investment credit in a year to the first $25,000 of tax liability plus 50 percent of the tax liability in excess of $25,000. In the case of all public utilities, the committee decided to raise the limitation on the amount of the investment credit that may be taken in a year from 50 percent of tax liability in excess of $25,000 to 75 percent in 1974 and 1975, and then to decrease the limit to 70 percent in 1976, 65 percent in 1977, 60 percent in 1978, and 55 percent in 1979. The existing 50-percent limitation will apply thereafter.

Sec. 242. Investment credit to be available for railroad rolling stock eligible for amortization.

The 7-percent investment tax credit will be available for all of the types of railroad investment eligible for 5-year amortization. Taxpayers under present law may not take the investment credit and rapid amortization for the same equipment.

Sec. 243. Investment credit in the case of movie and television films.

Prior to 1971, it was not clear whether (and if so, under what conditions) the investment credit was available for movie or television films. A court case held that movie films were tangible personal property eligible for the investment credit. In the Revenue Act of 1971, it was made clear that motion pictures and television films are to be treated as tangible personal property which is eligible for the investment credit (*i.e.*, section 38 property). However, there still are important unsettled issues, such as how to determine useful life, the basis on which the credit is computed, and how to determine whether use is predominantly within the United States.

The committee decided to provide different methods to deal with the problems of the proper treatment of the investment credit for motion pictures and television films for the past and for the future.

For the past, one of two alternatives would be available. The first method available for the past is what in most respects has been the IRS litigation position. A taxpayer under this method would be eligible to receive the full credit (or any partial credit) for their films if it is demonstrated on a film-by-film basis that the film satisfied both the useful life requirement and the requirement that there must be no predominant foreign use. For purposes of the useful life test, the useful life of the film is to be treated as ending at the end of the first year in which for depreciation purposes it was estimated that 90 percent or more of the depreciable cost of the film would be recovered. For purposes of the predominant foreign use test, a film is to be treated as used predominantly in foreign markets if, in any year (and not on a cumulative basis), more than 50 percent of the gross revenues from the film resulted from showing the film abroad.

A second alternative method is also to be available for prior years. This method may be elected by a taxpayer for all years prior to 1975 (with respect to which an investment credit was available) or only with respect to years prior to the reenactment of the investment credit on August 15, 1971. If this method is elected, unused investment credits may not be carried over from years in which this method is used to any subsequent years in which any other method of determining the investment credit is used.

Under this second alternative, a taxpayer may elect to take an investment credit on the basis of 40 percent of the cost of all of his films without regard to the estimated useful life of the film for purposes of depreciation and also without regard to whether the film is shown predominantly outside of the United States. Under this method, the credit would be based on the total cost of production, including capitalized production costs, a reasonable allocation of general overhead costs, salaries paid to the actors and production crew, costs of "first" distribution of prints, and the cost of the story being filmed. The cost for this purpose would include so-called residuals, but in the case of participations with respect to actors or others, it would include only those which are guaranteed. Films such as news features which are essentially transitory in nature, as well as films which are produced and shown exclusively in foreign countries, would not be eligible for the credit.

In addition, any taxpayer who has received final judgment on his entitlement to the investment credit for any prior year may elect to have his right to the investment credit for all years beginning prior to January 1, 1975, determined under present law, as interpreted by the courts, rather than by any of the alternatives set forth above.

For future years, taxpayers could elect to take an investment credit on a two-thirds basis for all films (instead of determining useful life on a film-by-film basis).

Also for the future, the availability of the investment credit would not depend on whether the film was predominantly used within the United States or in foreign countries; instead, the amount of the credit would depend on where the film is produced, rather than where receipts are derived from the showing of the film. For this purpose, however, films, such as news features, which are essentially transitory in nature, would not be included in the base on which the two-thirds credit is computed.

If 80 percent or more of the direct production costs of a film are incurred in the United States, a taxpayer would be entitled to an investment credit (on the same credit base as indicated above under the 40-percent-method with respect to prior years), except that the credit base would not include direct expenses for foreign production or for salaries paid for services performed abroad (unless in this latter case the salaries were paid to U.S. persons and were subject to U.S. tax). In determining whether this 80-percent test is met, however, only direct costs of production will be taken into account. (Overhead costs and the costs of screen rights, for example, for this purpose would not be taken into account.)

If less than 80 percent of the production costs are incurred for U.S. production, a taxpayer could still receive a credit to the extent of *direct* U.S. production costs. The credit base in this case, however. would not include such items as general overhead costs or costs of acquiring screen rights or any costs of foreign production, except for salaries paid to U.S. persons subject to U.S. tax.

The committee also agreed that the investment credit should be available in the case of films to the persons who bear the risk of loss if the film is not a successful picture. This rule applies under any of the alternatives set forth above.

Sec. 244. Tax credit for postconsumer solid waste materials.

To stimulate the recycling of postconsumer solid waste into productive uses, the committee decided to provide a tax credit equal to 7 percent of the purchase price of certain solid wastes by the firm that uses the materials in a recycling process. The credit will be available for such solid wastes as paper, glass, textiles and nonferrous metals. The credit will phase out if the current price for postconsumer solid wastes exceeds twice a base price adjusted for increases in the consumer price index. This provision will expire on December 31, 1979.

Sec. 245. Investment credit for certain leased commuter cars.

The committee agreed to allow a governmental unit to treat the lessee as having acquired property for purposes of the investment credit to the extent the lessee has actually paid an amount toward the purchase of the property. This is intended to cover cases where a railroad paid an amount to a local unit toward the purchase of urban mass transit cars which under the Urban Mass Transportation Act of 1964 were required to be owned by the governmental unit and, as a result, the railroad company was not eligible for the investment credit for the amount it paid toward the purchase of the cars.

Part V—Industrial Development Bonds

Sec. 251. $10,000,000 lifetime exemption from industrial development bond provision.

The committee agreed to raise the limit on the small issues of industrial development bonds that qualify for tax-exempt status. Under present law, the limits on these small issues are $1 million on the face amount of the bond issue in any one year or $5 million on the total cost of the facility incurred over a 6-year period.

The committee action raised the ceiling on small issues to $10 million. The small issue exemption to the industrial development bond provision will apply only if the proceeds are used to construct a facility that will be a self-contained, operational unit and will not require capital expenditures from other sources.

Part VI—Bank Holding Companies

Sec. 261. Distributions pursuant to Bank Holding Company Act Amendments of 1970.

The committee agreed to provisions dealing with the income tax treatment of divestitures of either bank or nonbank assets by bank holding companies required by the Bank Holding Company Act Amendments of 1970.

The committee's decision provides for three possible ways in which tax relief can be obtained by individuals and corporations with respect to divestitures made pursuant to the 1970 bank holding company legislation. All of these methods would be available with respect to assets acquired by the bank holding company on or before July 7, 1970. The relief would also be available with respect to property acquired after such date if the property was received in certain tax-free transactions. This would apply to type "A" reorganizations (mergers) and type "B" reorganizations (stock for stock exchanges) as well as recapitalizations and mere changes in identity.

The first method provided by the committee provides for the stock of the bank or nonbank corporation to be distributed tax free to the shareholders of the bank holding company. The committee intends that this treatment be essentially the same as that provided in connection with the 1956 and 1966 bank holding company divestiture legislation. The "spin-off" treatment would be available with respect to stock distributions occurring after July 7, 1970.

The second method will be the so-called "rollover" treatment. This would allow the tax on the gain from a sale pursuant to the divestiture to be deferred if the proceeds of the sale are reinvested in qualified replacement property (including inventory, accounts receivable, and depreciable property), if the basis of the qualifying replacement property is reduced and if, in the case of reinvestment in stock, the basis of both the stock and property of the corporation which is qualified replacement property, is reduced.

Sec. 262. Installment payment of tax with respect to bank holding company divestitures.

The third method provided by the committee's tentative decision would permit a bank holding company selling either bank or nonbank property to pay the tax on the gain realized on the sale in equal annual installments over a period beginning in the year after the disposition and ending no later than 1985. The bank holding company may be required to furnish a bond in the amount of the tax due. This method would be available for sales after July 7, 1970, of assets which could be distributed tax-free under the "spin-off" provision. The installment payment of tax is also to be available in certain situations where the divestiture is compelled by State law.

Part VII—Real Estate Investment Trusts

Sec. 271. Deficiency dividend procedure.

The committee agreed to a provision establishing a deficiency dividend procedure which would allow a REIT that fails to meet the income distribution requirements upon an audit by the IRS to make a late distribution to its shareholders to avoid disqualification. This procedure would only be available if the REIT initially missed the 90-percent distribution requirement for reasonable cause. The REIT would be subject to interest and penalties on the amount of the adjustment.

Sec. 272. Trust not disqualified in certain cases where income tests were not met.

A REIT that fails to meet the income source tests upon audit by the IRS would not be disqualified but would be allowed to pay tax on the amount by which it failed to meet the source tests. This provision would be available only if the REIT initially had reasonable ground to believe and did believe that it met the income source tests.

Sec. 273. Treatment of foreclosure property and property held for sale to customers.

A REIT would not be disqualified because of income it receives from foreclosure property since the REIT should not be held responsible for the type of lease or other transaction entered into by its mortgagee. At the election of the REIT, a 2-year grace period (generally subject to 2, one-year extensions) would be afforded so that the REIT could liquidate the foreclosed property in an orderly manner. The REIT would pay corporate tax on the nonqualified income on the property received from foreclosure during the grace period.

A REIT would be permitted to have a limited amount (up to one percent of its gross income) of income from property held for sale to customers but this income would be subject to corporate tax. Any income in excess of one percent would be subject to an additional tax rather than disqualify the REIT, provided that the REIT initially had reasonable ground to believe that the excess income was not from such sources.

Sec. 274. Other changes in limitations and requirements.

Certain types of income which customarily are earned in a real estate business which do not presently qualify under the income source test for a REIT are to be treated as qualifying income. These include (a) certain rents from personal property leased together with real property; (b) charges for services customarily furnished in connection with the rental of real property whether or not such charges are separately stated; and (c) commitment fees received for entering into agreements to make loans secured by real property. Since in view of these and other changes a significant portion of income is to be removed from the category of nonqualified income, the income source requirements are increased so that nonqualified income could be only 5 percent of gross income (rather than the present 10 percent). Also a corporate tax will be imposed on nonqualified income at the REIT level.

A REIT would be permitted to operate in corporate form. (Under present law a REIT must operate as a trust or association.)

Other changes are also to be made in technical rules applicable to REITs, such as those concerned with income from sales of mortgages held for less than 4 years and options to purchase real property.

Any interest that depends in whole or in part on income or profits is not to be treated as qualifying interest.

Sec. 275. Excise tax.

In view of the proposed deficiency dividend procedure, the committee agreed to encourage prompt dividend distributions by modifying the present rule dealing with dividends paid by a REIT after the close of the taxable year to require a 3-percent charge on the amount by which a REIT actually distributes less than 75 percent of its income in the year received. Also, a new REIT would be required to be on a calendar year for tax purposes.

Part VIII—Cooperative Housing Associations

Sec. 281. Tax treatment of certain cooperative housing associations.

The committee agreed to provide that in the case of homeowner associations, condominium housing associations, and cooperative housing corporations, only the investment income and income derived from a trade or business is to be taxable. A deduction would be allowed for expenses directly attributable to any investment income and any income derived from a trade or business. Assessments for the administration, maintenance and operation of the homeowners association, etc., would not be taxable.

Part IX—Other Changes

Sec. 291. Transfers of section 1245 property or section 1250 property to tax-exempt organization which uses such property in an unrelated trade or business.

Under present law, there is no recapture of depreciation under section 1245 in the case of certain tax-free transactions of property where the basis of the property in the hands of the transferee is determined by reference to its basis in the hands of the transferor. However, this rule does not apply to a disposition of property to an organization (other than a cooperative as described in section 521) which is exempt from Federal income tax.

The committee decided to provide that depreciation would not be recaptured under section 1245 in any case where property is disposed of in tax-free transactions to an organization exempt from Federal income tax if the property is used by the transferee in an unrelated trade or business. However, if the property ceases to be used in an unrelated trade or business, then, this property is to be treated as being disposed of by the transferee on the date it ceases to be so used.

Sec. 292. Distribution deduction for certain cemetery perpetual care fund trusts.

Under present law, the IRS has taken the position that cemetery perpetual care funds established by a taxable cemetery are subject to tax since they are discharging an essential function of the profit-making cemetery corporation; that is, maintaining the cemetery, burial lots and crypts.

The committee has agreed to provide a special deduction in computing income of a cemetery perpetual care fund for amounts paid or expended by the fund for the care and maintenance of cemetery property in which interment rights have been sold. The amount of this deduction is to be limited to the maximum of $5 times the aggregate number of cemetery grave sites which have been sold. This provision is to be effective from 1964, the year in which the IRS first gave public notice of its position regarding the tax treatment of cemetery perpetual care funds.

Sec. 293. Player contracts in case of sports enterprises.

In the case of sports enterprises, the committee agreed to specify clearly the portion of an aggregate amount paid to purchase a team or group of assets which is allocable to player contracts. The committee agreed to specify that the amount allocable to player contracts by a purchaser could not exceed the amount of the sales price allocated to such contracts by the seller.

Sec. 294. Common trust funds of affiliated banks.

The committee agreed to permit banks that are members of the same affiliated group to have a combined trust fund for tax purposes during the period of the affiliation.

Sec. 295. Interest on certain corporate indebtedness.

The committee agreed to eliminate the limitation on the deduction of interest where debt is issued to acquire stock of any corporation in which the issuing corporation owned at least 50 percent of the stock on October 29, 1969, the effective date of the provision in the Tax Reform Act of 1969 limiting the deduction of interest on indebtedness incurred by a corporation to acquire the stock or assets of another corporation.

Sec. 296. Redemption of stock with appreciated property.

The committee decided to permit the application of constructive ownership rules for purposes of the 10-percent ownership of stock test which must be met before a corporation may distribute appreciated property to the shareholder in redemption of his stock without recognizing any gain.

Sec. 297. Pooled mortgage funds.

The committee agreed to include certain pooled mortgage funds as qualifying real property loans for purposes of the special bad debt reserve treatment for savings and loan associations and mutual savings banks. This covers an instrument, which is essentially a bond backed by a pool of mortgages, that is issued by the Federal Home Loan Mortgage Corporation.

Sec. 298. Gain from dispositions of interests in oil and gas wells.

The committee decided to treat as ordinary income any gain on the disposition of interests in oil and gas wells to the extent of the excess of the intangible drilling deductions taken with respect to those wells over the deductions that would have been allowed had the expenses been capitalized.

Sec. 299. Disallowance of deductions for entertainment of public officials.

The committee agreed to deny deductions for entertainment (including meals) or gifts to Government officials or employees.

TITLE III—CHANGES IN TREATMENT OF FOREIGN INCOME

Part I—Amendments Primarily Affecting Individuals

Sec. 311. Repeal of exclusion for income earned abroad by United States citizens living or residing abroad.

The exclusion from income under present law of $20,000 (or, in some cases, $25,000) for income earned abroad by U.S. citizens living or residing abroad is to be phased out over a four-year period. Also, the committee agreed to a similar four-year phaseout of the exclusion for certain allowances of government employees based abroad. In lieu of these exclusions, the committee agreed to a $1,200 deduction for certain tuition expenses of dependents of taxpayers employed outside the United States. Further, the committee agreed to an exclusion from gross income for municipal-type services furnished in a foreign country by an employer on a nondiscriminatory basis.

Sec. 312. Foreign trusts having one or more United States beneficiaries to be taxed currently to grantor.

Income of foreign trusts established by a U.S. grantor which has one or more U.S. beneficiaries is to be taxed currently to the grantor under the existing so-called grantor trust rules of the Code.

Sec. 313. Interest charge on accumulation distributions from foreign trusts.

In the case of accumulated income of foreign trusts which is not taxed on a current basis, an interest charge is to be added to the tax paid by U.S. beneficiaries when they receive accumulated income distributions.

Sec. 314. Excise tax on transfers of property to foreign persons to avoid Federal income tax.

The 27½ percent excise tax which, under present law, applies to transfers of appreciated stocks or securities to a foreign trust or a foreign corporation or partnership, is to be increased to 35 percent and apply to transfers of all types of appreciated property.

Part II—Amendments Affecting Tax Treatment of Controlled Foreign Corporations and Their Shareholders

Sec. 321. Repeal of minimum distribution exception to requirement of current taxation of subpart F income.

The exception in present law which permits deferral of income earned through so-called tax haven operations by foreign subsidiaries of U.S. corporations in cases where the foreign corporation (or various combinations of related foreign corporations) distribute certain minimum dividends to their U.S. shareholders is to be repealed. The effect of repealing this exception is to tax currently all income of foreign subsidiaries of U.S. corporations which is deemed to be tax haven income under the existing so-called subpart F rules of the Code.

Sec. 322. Exclusion of sales income from foreign manufacturing from foreign base company sales income.

The committee agreed to modify the definition of foreign-base company sales income under subpart F to exclude from that definition sales income arising from the sale of goods manufactured abroad.

Sec. 323. Repeal of exception to requirement of current taxation of subpart F income for reinvestment in less developed countries.

The provisions in present law ending deferral for certain tax-haven income (so-called subpart F income) are to be modified to end the exception which presently applies where the dividends are reinvested in less-developed countries.

Sec. 324. Amendment of provision relating to investment in United States property by controlled foreign corporations.

The provision in present law under which U.S. shareholders of a controlled foreign corporation are deemed to have received dividends from that corporation if it reinvests its profits in the United States is to be limited to cases where the foreign corporation engages in a leasing arrangement or lends money to a related U.S. person.

Sec. 325. Repeal of exclusion for earnings of less developed country corporations for purposes of section 1248.

The provisions of present law providing for ordinary income taxation to U.S. shareholders on gains from the sale of stock in foreign corporations (to the extent of the shareholder's pro rata share of the earnings and profits of that corporation) are to be applied in the same manner to less-developed country corporations as they apply to other foreign corporations.

Sec. 326. Shipping profits of controlled foreign corporation to be taxed currently except to extent reinvested in shipping operations.

The rule under present law which permits deferral of U.S. tax for shipping income received by a foreign subsidiary of a U.S. corporation is continued, but is to be limited to the extent that the profits of these corporations are reinvested in shipping operations.

Part III—Amendments Affecting DISC

Sec. 331. Denial of DISC benefits with respect to certain items.

The committee agreed to make the DISC provisions inapplicable to agricultural and natural resource products and to goods subject to export control.

Sec. 332. Termination of application of DISC provisions in connection with trade agreement to reduce barriers to international trade.

The committee agreed to give the President's Special Representative for Trade Negotiations authority to negotiate the elimination of DISC benefits as part of multilateral agreements on trade.

Part IV—Amendments Affecting Treatment of Foreign Taxes

Sec. 341. Requirement that foreign tax credit be determined on overall basis.

The per-country limitation on the foreign tax credit is to be repealed for all industries. This extends and is consistent with the committee's earlier action in the Oil and Gas Energy Tax Act, which repeals this limitation in the case of oil and gas companies. The repeal would be effective as of January 1, 1975.

Sec. 342. Recapture of foreign losses.

Consistent with earlier committee action in the Oil and Gas Energy Tax Act, the committee agreed to a provision to require that any foreign losses which offset U.S. income will be recaptured in future years when foreign income is earned.

Sec. 343. Dividends from less developed country corporations to be grossed up for purposes of determining United States income and foreign tax credit against that income.

Dividends received by U.S. shareholders from less-developed country corporations are to be "grossed-up" by the amount of taxes paid in the less-developed country both for purposes of computing U.S. income and for purposes of computing the U.S. foreign tax credit applicable to that income.

Sec. 344. Treatment of capital gains for purposes of foreign tax credit.

In cases where a U.S. taxpayer sells a capital asset in a foreign country, the amount of any income received from the sale is not to be included as foreign source income for purposes of computing the taxpayer's foreign tax credit limitation if no substantial foreign tax is paid upon the sale of the asset. In this case and in cases where U.S. source capital gains are realized, the foreign tax credit limitation is to be adjusted to the extent of the capital gains.

Part V—Money or Other Property Moving Out of or Into the United States

Sec. 351. Portfolio investments in United States of nonresident aliens and foreign corporations.

The 30-percent withholding tax on dividends and interest received from the United States by foreign persons is to be repealed except in the case of dividends and interest from investments that constitute a direct investment in U.S. securities rather than a portfolio investment.

As part of this provision, the present exemption from the 30-percent withholding tax which applies to foreign deposits held in United States banks (which under present law would expire on December 31, 1975) is to be made permanent. In these cases where the withholding tax is not to apply, the stock and securities are to be exempt from U.S. estate tax.

Sec. 352. Changes in ruling requirements under section 367; certain changes in section 1248.

The committee agreed to eliminate the requirement in present law (section 367 of the Internal Revenue Code) that an advance Internal Revenue Service ruling must be obtained for tax-free exchanges involving a foreign corporation related to United States taxpayers. In addition, the Committee instructed the staff to set out rules under which no Internal Revenue Service rulings would be required. The effective dates of the provisions in the bill relating to advance rulings under section 367 permit after-the-fact rulings on corporate reorganizations solely involving foreign corporations to be obtained until 183 days after the date of enactment if the exchange was in a taxable year beginning after December 31, 1962, and before December 31, 1974.

Sec. 353. Contiguous country branches of domestic mutual life insurance companies.

The committee agreed to permit mutual life insurance companies maintaining separate life insurance operations in countries contiguous to the United States to treat these operations in a manner similar to foreign subsidiaries.

Part VI—Possessions Corporations; Western Hemisphere Trade Corporations

Sec. 361. Tax treatment of corporations conducting trade or business in possessions of the United States.

The committee agreed to several changes in the treatment of possessions corporations. The requirements for qualifying as a possessions corporation will remain the same as under present law except that such corporations will qualify only if they elect for a period of 10 years to become a possessions corporation. In lieu of the exclusion under present law, a new tax credit is provided for possessions corporations equal to the U.S. tax attributable to the corporation's income from a possession trade or business and from qualified possession investments. Other income of a possessions corporation is subject to the normal U.S. tax without any offset by this new credit. Finally, the committee agreed to permit corporations receiving dividends from possessions corporations to be eligible for the dividends received deduction.

Sec. 362. Western Hemisphere Trade Corporations.

The committee agreed to phase out over a five-year period the provision in present law which provides a 14-percent lower tax rate for Western Hemisphere Trade Corporations.

TITLE IV—OIL AND GAS ENERGY PROVISIONS

Part I—Tax Treatment of Domestic Oil and Gas Production

Sec. 411. Windfall profits tax; plowback credit.

"Windfall profits" tax.—An excise tax of 5 years duration is imposed on the "windfall profit" element of the price of domestically produced crude oil. The windfall profit, for this purpose, equals the excess of the price (less the increase in severance taxes over the base period) over a base price, which begins at fifty cents per barrel above the ceiling price established by the Cost-of-Living Council as of December 1, 1973, (on the average about $4 per barrel). Windfall profits, however, cannot exceed 75 percent of taxable income from a property. The level at which the tax is to apply rises so that the tax is gradually phased out over the 5-year period. Graduated rates ranging from 10 percent to 85 percent are imposed on these windfall profits.

Credit for reinvested earnings.—A credit for certain types of investments is allowed to reduce the windfall profits tax otherwise payable. This is known as a "plowback credit". After 1975 this plowback credit may offset the entire windfall profits tax liability. In 1975 the credit may not exceed 50 percent of the tax plus the proportion of the remaining 50 percent represented by the production of 3,000 barrels a day or less. Investment which qualifies for reduction of this tax includes expenditures for (1) intangible drilling and development costs and geological and geophysical costs; (2) depreciable assets used in exploration and development of oil or gas (including oil shale); (3) the conversion of oil shale, coal, or liquid hydrocarbons into oil or gas; (4) the refining of oil or gas; (5) oil or gas pipelines and related facilities; (6) secondary or tertiary recovery of oil or gas; and (7) to a limited extent, the acquisition of oil and gas leases (other than offshore leases). Two dollars of plowback credit will be allowed for one dollar of qualified investment when the expenditures are not deductible under the regular corporate income tax in the year incurred, except for lease acquisition costs.

Sec. 412. Phaseout of percentage depletion for domestic oil and gas production.

Percentage depletion for domestic oil and gas is generally phased out by reducing the 22 percent depletion rate to 15 percent in 1974, 8 percent in 1975, and zero thereafter. However, under certain conditions, a taxpayer may elect one of three provisions, any one of which holds the depletion rate on oil to 15 perrcent until 1979, at which time it is to be reduced to zero. The first of these three provisions relates to production of up to 3,000 barrels a day, the second to production from "stripper" wells (those producing 10 barrels or less per day), and the third to production from wells located north of the Arctic Circle.

In the case of federally regulated natural gas, the rate of percentage depletion is to remain at 22 percent unless the price of this gas, on a BTU equivalency basis, equals or exceeds the price of free oil. In the case of other natural gas, the rate of percentage depletion generally is to go down as specificed above in the case of oil—to 15 percent in 1974, 8 percent in 1975 and zero in 1976. However, the rate is to remain at 22 percent as long as fixed price contracts in force on April 10, 1974, continue in effect.

Other changes include a provision for expensing, rather than capitalizing, geological and geophysical costs after an oil producer no longer receives percentage depletion, the repeal of the limitation of percentage depletion to 50 percent of net income, and assurance that geothermal deposits, if eligible for percentage depletion under present law, are not to be affected by the bill.

Sec. 413. Treatment for purposes of the investment credit of certain property used in international or territorial waters.

The bill also eliminates the investment credit for seagoing drilling rigs in the case of future orders, except those used in the waters of the northern portion of the western hemisphere.

Part II—Tax Treatment of Foreign Oil and Gas Production

Sec. 421. Repeal of percentage depletion in the case of foreign oil and gas wells.

Percentage depletion on income from foreign oil and gas production is repealed for 1974 and subsequent years.

Sec. 422. Limitation on foreign taxes attributable to foreign oil and gas extraction income; separate computation of foreign tax credit for oil and gas related income.

Foreign tax credits from foreign oil and gas extraction income are limited to a level of 10 percent above the U.S. rate (52.8 percent). The excess credits which are allowable may only be used to offset United States tax on foreign oil-related income. These rules generally are applicable for 1974 and subsequent years.

Repeal of per country limitation.—The limitation on the foreign tax credit, which permits foreign losses to be offset against domestic income while foreign tax credits are claimed on foreign income in other countries, is repealed effective for 1975 and subsequent years.

Recapture of losses offset against domestic income.—To the extent foreign oil-related losses may still offset domestic source income with the repeal of the per country limitation (referred to above), the losses, in effect are to be recaptured in subsequent years when foreign oil-related income is earned or foreign oil-related assets are disposed of. This applies to losses incurred in 1975 and subsequent years.

Sec. 423. Denial of DISC benefits with respect to energy resources.

DISC (Domestic International Sales Corporation) tax-deferral benefits are denied to income from export sales of oil, gas, coal, uranium and their primary products after March 28, 1974.

Sec. 424. Imposition of quantitative limitations, duties, taxes, or fees on the importation of petroleum and products derived from petroleum.

The right of the President to impose any quota, duty, tax or fee on the importation of petroleum is to be restricted to cases where the price of the imported petroleum is equal to or less than the price of petroleum produced in the United States and the goal of national self-sufficiency would be adversely affected without the action. Similarly, any duty, tax or fee imposed on gasoline or other products derived from petroleum may not exceed the charge currently applicable to petroleum unless the President determines the action is necessary to offset the cost advantage of refineries located outside of the United States. The quota, duty, tax, or fee provided in either of the two situations referred to above may not be on a discriminatory basis except: (1) to encourage new refinery capacity in the United States; (2) to preserve the competitive position of small refineries, independent marketers or the petrochemical industry; (3) because of considerations of national security; or (4) to favor imports from possessions of the United States. Provision is also made that Congress may override any Presidential action in these areas.

TITLE V—ADMINISTRATIVE AND MISCELLANEOUS CHANGES

Part I—Administrative Changes

Sec. 511. Income tax return preparers.

The committee agreed to a series of provisions dealing with tax return preparers which are designed to assist the Internal Revenue Service in its auditing practices by permitting it to retrieve and analyze by computer all returns prepared by the same preparer.

Tax return preparers who would be covered by these provisions are those persons who prepare, directly or through employees, a return or claim for refund for compensation. These rules would not apply to persons who render mere mechanical or processing assistance, regular employees who prepare returns of their employer as a usual incident of employment, fiduciaries who prepare returns for trusts or estates, or partners who prepare returns for partnerships.

The provisions agreed to by the committee which apply to the covered tax return preparers are as follows:

1. Each prepared return, statement or other document must contain the identification number of the return preparer and other data sufficient to identify the preparer. A $25 penalty is provided for each failure to comply, if without reasonable cause.

2. Each preparer must furnish to taxpayers a copy of the return or claim for refund prepared by the tax return preparer at the time the return is given for the taxpayer's signature. A $25 penalty is provided for failure to comply, if without reasonable cause.

3. Each return preparer or every person employing a tax return preparer must file an annual report listing the name, address, identification number, and place of work of each preparer they employ. This report is to be filed by July 31 for a 12-month period ending June 30. Failure to comply without reasonable cause would result in a $100 penalty for each failure to file an annual return and a $5 penalty for each failure to include a name, identification number and place of work on the annual report. These penalties are not to exceed $20,000 for a 12-month period.

4. Each return preparer or employer of return preparers must retain for three years either a list of taxpayers for whom returns were prepared or copies of their returns and claims for refunds. A $50 penalty is provided for each failure to retain a copy of a return or to list a taxpayer for whom a return was prepared, up to a maximum of $25,000 for all returns in a year.

5. Penalties are also provided for negligence or fraud on the part of the tax return preparer. A $100 penalty is provided for negligent or intentional disregard of Internal Revenue Service rules or regulations by a tax return preparer. A $500 penalty is provided for a will-

ful attempt to evade, defeat or understate any tax by a tax return preparer. A separate penalty may be imposed for each return or claim for refund. The penalties are flat amounts rather than a percentage of understatement of tax (as is the case under present law with respect to negligence or fraud on the part of a taxpayer) in order to avoid the necessity of determining a taxpayer's exact tax liability in a proceeding against the preparer. With respect to all the penalty provisions, the period of limitations for assessing penalties would be three years from the filing date of the return or claim for refund, except that penalties for a willful attempt to evade, defeat, or understate any tax could be imposed at any time.

6. In order to prohibit a tax return preparer from continuing to prepare returns when it is determined that he has engaged in improper conduct with respect to the preparation of tax returns, an injunctive proceeding could be brought against such a preparer. The grounds for such action may include (1) engaging in conduct subject to penalties, (2) misrepresenting qualifications (including eligibility to practice before the Internal Revenue Service), (3) guaranteeing the payment of a tax refund, or (4) engaging in other similar conduct that substantially interferes with the proper administration of internal revenue laws. A tax return preparer who files a bond of $50,000 to guarantee payment of further penalties would not be subject to an injunctive proceeding for penalty-type conduct.

7. The Internal Revenue Service would be authorized to provide the names, addresses, and taxpayer identifying numbers of preparers to State authorities charged with enforcing State provisions regulating tax return preparers.

Sec. 512. Increase in interest charged and paid from 6 percent to 9 percent.

The committee agreed to increase the interest rate paid by taxpayers on tax deficiencies and by the Government on tax overpayments from 6 percent to 9 percent per year.

The committee agreed to increase the addition to tax for underpayment of estimated tax from 6 percent to 9 percent per year.

Sec. 513. Assessments in case of mathematical or clerical errors.

The committee also agreed to clarify the definition and treatment of mathematical or clerical errors made on returns by taxpayers in cases where the Internal Revenue Service corrects the error and makes an immediate assessment if there is an underpayment or reduces the amount of a refund if there is an overpayment.

Sec. 514. Voluntary withholding of State income tax in the case of certain legislative officers and employees.

The committee agreed to permit the paying officers of the House of Representatives to enter into agreements with requesting States to withhold State income tax from any members or employees of the House who request it.

Sec. 515. Withholding tax on excludable contributions for section 403(b) annuities.

The committee decided to exclude from the definition of wages subject to withholding tax any remuneration paid under a plan described in section 403(b) to the extent that the payment does not exceed the amount excludable from the employee's income. These plans are annuity contracts purchased by public schools and tax-exempt organizations.

Sec. 516. Withholding State and city income taxes from the compensation of members of the National Guard or the Ready Reserve.

The committee decided to extend the provision under present law requiring the Treasury to enter into agreements with States and cities to withhold income taxes from Federal employees to members of the National Guard and Ready Reserve when they are paid for performing regular training.

Sec. 517. Withholding tax on certain gambling winnings.

The committee agreed to institute withholding for income tax of 20 percent on gambling winnings of more than $600 when the odds exceed 300 to 1. For lottery winnings, however, the 20-percent withholding for income tax will be levied regardless of odds whenever the proceeds exceed $100.

Part II—Political Organizations

Sec. 521. Tax on certain income of political organizations.

Political parties or committees (and separate campaign funds) are generally to be treated as exempt organizations for tax purposes. As a result, contributions received by these committees or parties will not be considered as income, and expenditures for campaign purposes shall not be allowed as deductions. Political parties or committees, however, will be subject to tax on investment income, unrelated business income, and capital gains. A $100 minimum is provided with respect to investment income. As a result, a political party or committee will not be subject to tax on investment income unless this income in excess of $100. A tax return will be required to be filed only by those parties or committees that have taxable income (after deducting the $100 minimum for investment income). Deductions will be allowed to the extent they relate to the earning of the taxable income. In this respect political parties and committees will be taxed generally as corporations but the surtax exemption is not to be allowed. In addition, with respect to any dividends received as investment income, the dividends received deduction is not to be available.

Sec. 522. Extension of existing credit and deduction provisions for political contributions to contributions for newsletters; two-year rule for announcing candidacy.

Under present law, a limited credit or deduction is allowed for campaign contributions to individual candidates (and political parties and committees) but only if the person "is" a candidate for nomination or election to an elective public office in the year of the contribution. A person is considered to be a candidate only if he has "publicly announced" that he is a candidate, and meets the qualifications prescribed for holding office. The committee has agreed to extend this treatment by allowing the credit or deduction for campaign contributions in the year before a person announces his candidacy.

Generally, newsletter committees (and separate funds) are to be treated for tax purposes in the same way as campaign committees. That is, contributions received by the newsletter committee will not be taxable to the individual or committee. In addition, funds spent by the newsletter committee in the course of publishing a newsletter are not to be deductible by the committee or individual. However, the committee will be subject to tax to the extent it has investment income over $100, has net unrelated trade or business income, or net capital gains.

In addition, the tax law will be changed to conform to the law governing the franking privilege. Consequently, the credit or deduction for campaign contributions will be allowed if the funds contributed are used for newsletters.

Sec. 523. Transfer of appreciated property to political organizations.

Appreciated property transferred by a taxpayer to a political party or committee will be taxed to the donor at the time of the transfer. That is, the donor will be subject to tax on the difference between the value of the property at the time of the contribution and his cost or other basis. The political party or committee will be subject to tax on any appreciation in the value of property from the time it is received until sale or exchange.

The committee also provided that gain or loss will not be recognized on sales of contributed property by a political organization before August 2, 1973.

Sec. 524. Gift tax not to apply to contributions to political organizations.

The gift tax will not apply to contributions to political parties or committees.

Part III—Certain Tax Exempt Organizations

Sec. 531. Declaratory judgments with respect to section 501 (c)(3) status and classification.

Because of the present usual long delay in getting a court test of any adverse determination by the IRS, and the almost certain loss of contributions during this period of delay, the committee has agreed to provide a procedure whereby an organization may ask the Tax Court for a declaratory judgment as to its tax-exempt status and classification under section 501(c)(3) of the Internal Revenue Code.

Under the declaratory judgment procedure agreed to by the committee, if the IRS fails to issue a favorable exemption ruling (or fails to rule that the organization is a "public charity" rather than a private foundation), an organization seeking exemption under section 501(c)(3) of the Code may petition the Tax Court for a declaratory judgment as to its exempt status, its classification as a private foundation, its classification as a private operating foundation, or its classification as an organization eligible to receive deductible charitable contributions. A similar procedure will be available from a final adverse determination by the IRS as to any of these items.

Sec. 532. Electioneering by civic leagues, et cetera.

Under present law, an organization exempt from Federal income tax under section 501(c)(4) can engage in some election campaign activities without risking the loss of exemption. The committee decided to provide that an organization cannot be exempt from Federal income tax under this provision if it participates in or intervenes in any political campaign on behalf of any candidate for public office.

Sec. 533. Social clubs.

The committee agreed to change the definition of social clubs for purposes of determining tax-exempt status from clubs *exclusively* engaged in nonprofit activities to clubs *substantially all* of whose activities are nonprofit. Also, the dividends received deduction is denied for the investment income of social clubs, employee beneficiary associations, and taxable membership organizations.

Sec. 534. Tax treatment of certain mutual cooperative telephone companies.

Under present law a mutual or cooperative telephone company is exempt from tax under section 501(c)(12) of the Code if 85 percent of its income consists of amounts collected from members for purposes of meeting the cooperative's expenses and losses. The IRS has taken the position that when the cooperative telephone company completes or terminates calls to its subscribers which are made by individuals who are subscribers of another company, the cooperative constructively receives income for this service from the other company (although in most cases payment is not made but the other company performs similar services for the cooperative). This treatment of income of this type may cause a telephone cooperative to fail to qualify as tax exempt because, on this basis, it does not receive 85 percent or more of its income from its members. The committee agreed to provide that income received by a cooperative from a nonmember telephone company for the performance of such service would not be considered in applying the 85-percent income test.

Sec. 535. Credit union insurance organizations.

The committee agreed to exempt from tax those mutual nonprofit organizations that provide reserve funds for, or insure shares in, credit unions.

Sec. 536. Exclusion from unrelated business income of gain from lapse of certain options.

The committee agreed to exclude from unrelated business income all gains on the lapse of options to buy or sell securities that are written by an exempt organization in connection with its investment activities.

Sec. 537. Exemption from unrelated business income tax of public entertainment activities at certain State and local fairs.

The committee decided to exclude from unrelated business income the income from public entertainment activities conducted at State, local or regional fairs conducted by agricultural or horticultural organizations.

Sec. 538. Five-year transitional rule for private foundation payout.

The committee decided that for a 5-year period beginning December 31, 1973, the private foundation charitable expenditure rules would be modified so that a foundation would not be required to reduce the value of its endowment below the value on December 31, 1970; however, this rule is not to reduce the charitable expenditure requirement below the greater of (1) 4 percent of the value of the endowment or (2) the foundation's income for the year.

Sec. 539. Certain dispositions of property before 1976 not subject to taxes on self-dealing.

The committee decided to add a temporary exception to the rules prohibiting self-dealing transactions (i.e., transactions between a private foundation and a disqualified person) to permit a private foundation to sell to a disqualified person property which is at present leased to a disqualified person. The sale must be for not less than the fair market value of the property and must be made before January 1, 1976.

Part IV—Excise Tax Changes

Sec. 541. Reduction of excise tax on beer for certain brewers.

Present law imposes a $9 excise tax on each barrel of beer produced for consumption or sale in the United States or imported into the country. The committee agreed to reduce this tax by $2 (from $9 to $7) for the first 60,000 barrels produced in a year but only for those brewers who produce no more than 2 million barrels a year.

Sec. 542. Home production of wine and beer.

Under present law the head of any family may produce up to 200 gallons of wine a year for family use without payment of tax. The committee agreed to extend this provision to individuals who are not heads of a family. Under the committee provision, any individual 18 years of age or older may produce wine for personal consumption without payment of tax. The amount of wine that could be produced without payment of tax in any household is to be limited to 100 gallons of wine a year where there is only one individual 18 years of age or older and to 200 gallons of wine a year if there are two or more individuals 18 years of age or older in the household.

The committee also agreed to apply similar provisions to the home production of beer.

Sec. 543. Distilled spirits.

The committee agreed to a series of modifications with respect to the tax treatment of distilled spirits. These are to: (1) eliminate the requirement that the name of the distiller or producer be on gin or vodka bottled in bond for export; (2) allow drawback of tax on distilled spirits and wines that are imported, bottled or packaged here, and subsequently exported; (3) allow producers to store distilled spirits on their bonded premises pending specified nontaxable dispositions of the spirits (such as export) without having their capital tied up in a tax payment during the storage period; (4) allow spirits bottled in bond or certain spirits returned to bonded premises for storage, under (3) above, to be transferred without payment of tax to a customs bonded warehouse for storage pending export; (5) allow spirits to be withdrawn from bond without payment of tax for specified scientific purposes additional to those now provided; (6) relax the conditions under which spirits may be mingled on bonded premises; (7) allow gin to be made with the extracted oils of juniper berries and other aromatics, as well as with the berries or other aromatics themselves, without payment of the rectification tax; and (8) extend the tax treatment presently given domestic distilled spirits in certain cases of loss or voluntary destruction to distilled spirits brought into this country from Puerto Rico or the Virgin Islands.

Sec. 544. Use of strip stamps for payment of distilled spirits tax.

The committee agreed to allow use of devices other than stamps to be used as evidence of payment of the excise tax on distilled spirits.

Sec. 545. Excise tax on cigars.

The committee agreed to change the present bracket system of taxing cigars on the basis of their intended retail price to a single ad valorem tax of 8½ percent of the intended wholesale price. The present limit of $20 per 1,000 cigars is retained.

Sec. 551. Helicopters used in timber harvesting or forest management.

The committee decided to exempt helicopter operations in timber harvesting and forest management from the aviation excise taxes on special fuels (sec. 4041), gasoline (sec. 4081) and the transportation of property for hire (sec. 4272).

Sec. 552. Gasoline tax refund procedure for aerial applicators.

The committee agreed to permit crop-dusters to get a full refund of the gasoline excise tax for the nonhighway use of gasoline, if the farm owner or operator waives his right to the refund.

Sec. 553. Lubricating oil.

The committee agreed to remove the refund or credit of the excise tax on lubricating oil for oil used off highways, except for oil used on farms. The revenue from this change will not be placed in the Highway Trust Fund.

Sec. 554. Tread rubber.

The committee agreed to provide credits or refunds of the manufacturers excise tax on tread rubber where tax-paid tread rubber is wasted in the recapping or retreading process, is used in the recapping or retreading of tires the sale of which is later adjusted, or is used in the recapping or retreading of tires which are exported, are sold to nonprofit educational institutions, or are sold as supplies for vessels or aircraft. The provision also makes it clear that credits or refunds in the case of new tires, the sale of which is later adjusted as a result of a guaranty or warranty, is to be based on the adjustment in price of the tire returned and is to be available whether or not the replacement tire is obtained from the same manufacturer or whether or not a replacement tire is obtained.

Sec. 555. Constructive sales price for application of excise tax on automotive parts.

The committee agreed that when automotive parts are sold in a non-arm's length transaction and the manufacturer makes bona-fide purchases or sales of similar articles to or from others, the constructive sales price (in applying the excise tax on automotive parts) is to be no higher than the lowest price determined with reference to the bona-fide sales. This provision will be retroactive for all open tax years.

Sec. 561. Computation of excise tax on communications services.

The committee agreed to remove from the base of the Federal excise tax on communications (telephone and telegraph) the amount representing State or local sales (excise) taxes where the tax is separately stated. The base for the Federal tax would, therefore, be the pretax amount actually billed to the customer.

Sec. 571. State conducted lotteries.

Present law exempts from the 10-percent wagering tax and occupational taxes State lotteries where the ultimate winners are determined by the results of a horse race.

The committee agreed to remove the requirement that the ultimate winners of State lotteries must be determined on the basis of the results of a horse race. The committee also agreed to exempt vending machines which dispense lottery tickets conducted and maintained by State lottery agencies from the occupational taxes on wagering.

Sec. 581. Tax treatment for retirement purposes of commissions received by certain State and local tax collectors.

The committee agreed to treat State or local tax collectors who work on a commission basis as self-employed for retirement purposes.

TITLE VI—REPEAL AND REVISION OF OBSOLETE, RARELY USED, ETC., PROVISIONS

The committee agreed to the provisions of the so-called "deadwood" bill (H.R. 25 in the 92nd Congress), which simplify the tax laws by removing from the Internal Revenue Code those provisions which are obsolete or no longer important and rarely used. The committee also updated H.R. 25.

This bill, which has been developed over a number of years, repeals almost 150 sections of the Internal Revenue Code and amends in approximately 850 other sections of the Code. The bill also makes other simplifying changes such as the substitution of the term "ordinary income" for phrases in the present law which obtain this result by referring to the income as "gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231."

The provisions deleted include those which deal only with past years, situations which were narrowly defined and are unlikely to reoccur, as well as provisions which have largely, if not entirely, outlived their usefulness. In some situations, the bill adds provisions to the public laws which preserve the right of persons to continue to receive benefits under code provisions repealed by the bill.

The provisions of the deadwood bill do not attempt to achieve simplification through substantive changes in existing law. Therefore, the provisions do not deal with policy issues or with substantive changes in generally applicable provisions.

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