THE TECHNICAL AMENDMENTS BILL OF 1960
H.R 9625 AND H.R. 9626

AN EXPLANATORY STATEMENT

PREPARED FOR THE

COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

BY THE STAFFS OF THE

JOINT COMMITTEE ON INTERNAL REVENUE TAXATION AND THE TREASURY DEPARTMENT

JANUARY 14, 1960

This explanation has not been considered nor approved by the Committee on Ways and Means nor by any member of that committee.

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PRELIMINARY STATEMENT

Representative Wilbur D. Mills (Democrat, of Arkansas), chairman of the Committee on Ways and Means, and Representative Noah Mason (Republican, of Illinois), ranking minority member of that committee, introduced on January 14, 1960, identical bills (H.R. 9625 and H.R. 9626, respectively) relating to miscellaneous areas of the tax laws. The following is an excerpt from the press release announcing the introduction of these bills:

> The legislation embodies various recommendations of the Treasury Department that have been reviewed by the staff of the Joint Committee on Internal Revenue Taxation. Mr. Mills stated that he expected the committee would consider this legislation when its schedule permits. He emphasized that he and Mr. Mason were introducing the legislation at the request of the Treasury Department so as to make it available to the public for study and comment and that neither of them necessarily approve or disapprove any of the provisions of the bills.

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EXPLANATION OF THE TECHNICAL REVISIONS OF THE INCOME, EXCISE, AND ADMINISTRATIVE TAX LAWS CONTAINED IN H.R. 9625 AND H.R. 9626

Section 1. Title, Effective Date, etc.

This bill is intended to make certain technical revisions in the income, excise, and administrative provisions of the Internal Revenue Code of 1954, and for other purposes. For that reason, it is provided that this bill be cited as the Technical Amendments Act of 1960. As a general rule, these amendments would be effective prospectively, unless otherwise specified.

PART I. INCOME TAX PROVISIONS

Section 2. Dependency Exemption for Certain Individuals Born in or Residing in American Samoa or Swains Island

Present law

Section 152(b)(3) of present law provides that the term "dependent" includes any individual who is a citizen of the United States, a resident of the United States, of a country contiguous to the United States, or a resident of the Canal Zone, Republic of Panama, and, in certain cases, the Philippines.

Problem

Both the 1939 Code and the 1954 Code contain the same general rule with respect to dependents, namely, that individuals may not be claimed as dependents if they are not citizens or residents of the United States. However, present law defines a dependent in terms of one who is a citizen of the United States while the 1939 Code defined a dependent in terms of one who is not a citizen or subject of a foreign country. The purpose of expressing the general rule in a positive way in the 1954 Code, rather than in the negative way of the 1939 Code, was to permit a person who may be a citizen both of the United States and of another country to be treated as any other citizen of the United States.

Unfortunately, this change in the manner of defining a dependent had an additional consequence. It operates to deny a dependency exemption for individuals who are citizens and residents of two U.S. possessions, American Samoa and Swains Island. Section 308 of the Immigration and Nationality Act, 8 U.S.C. 1408, provides that such persons are nationals but not citizens of the United States. Under the 1939 Code, such persons could qualify as dependents since they were not citizens of a foreign country.

The only cases which have been brought to the attention of the Service relate to certain dependents of U.S. naval personnel residing in American Samoa (and the adjacent Swains Island). The Judge Advocate General's Office of the Navy Department has indicated that less than 100 taxpayers in American Samoa were affected by this change in the 1954 Code. However, the exact number of dependents of these taxpayers could not be ascertained. That Office further stated that no other cases had been brought to its attention.

It is not believed that Congress intended in the 1954 Code to disqualify as dependents these persons who were included in the definition of a dependent under the 1939 Code.

Solution

The bill amends section 152 so as to include within the definition of a "dependent" an individual who is born in or is a resident of American Samoa or Swains Island and who is not a citizen or subject of a foreign country. By including such individuals within the definition of a "dependent," they would be accorded treatment similar to that which they received under the 1939 Code.

Section 3. Accrual of Taxes Related to a Definite Period of Time

Present law

Section 164(a) of the code allows a deduction for "taxes paid or accrued within the taxable year." Under this language, the accrual basis taxpayer is allowed a deduction in the year the taxes accrue regardless of when they are paid. As a general rule, developed through judicial and administrative interpretations, the date of the event which renders the taxpayer unconditionally liable for the tax is considered the proper accrual date. With respect to personal and real property taxes related to a period of time, the accrual date is generally considered either the assessment date, personal liability date, or the lien date, or a combination of these dates. Section 461(c) of the code allows accrual basis taxpayers, at their election, to accrue real property taxes which are related to a definite period of time ratably over the period of time to which they relate. Section 461(c) is limited to real property taxes and few taxpayers have elected to accrue those taxes ratably. Therefore, most taxpayers on the accrual basis accrue and deduct taxes related to a definite period of time in the taxable year in which the accrual date occurs.

Problem

Several States (including Michigan, Ohio, South Carolina, and West Virginia) have recently enacted legislation which has enabled accrual basis taxpayers to claim that they are entitled to deduct in 1 Federal taxable year property taxes for 2 full property tax years. The technique employed by the State legislatures to accomplish this is simply to cause the accrual event, such as the assessment date, for 2 years' property taxes, to fall within 1 year. Thus, in a State where real property taxes for the calendar year 1958 were assessed and became a personal liability on January 1, 1958, the State legislature would pass a law changing the assessment and personal liability dates for 1959 real property taxes from January 1, 1959, to December 31, 1958. In such a case, the accrual basis calendar year taxpayer may be successful in accruing and deducting in the Federal taxable year 1958 the real property taxes assessed for both 1958 and 1959. If the same State continues to assess property taxes for 1960 and all subsequent years on December 31 of the preceding year, the same taxpayer, having claimed the deduction for 2 years' property taxes in 1958, will still claim a deduction for 1 year's taxes in 1959 and for 1 year's taxes in each succeeding year in which taxes are assessed.

This type of State legislation has been widely publicized as being a "tax gimmick." At least one State has specifically provided that for State income tax purposes, the new accrual date shall be disregarded. It is evident that in many cases the primary purpose of such State legislation is to enable accrual basis taxpayers in those States to obtain a Federal income tax benefit.

If the State legislation accomplishes its purpose, a permanent and significant loss of revenue will result and unless remedial legislation is enacted the revenue loss may be significantly increased as other States may well take action similar to that taken by the States mentioned.

Solution

The bill provides an amendment which, in general, would deny an accrual basis taxpayer the right to deduct more than 1 year's taxes which relate to a definite period of time in 1 Federal taxable year. In a case where the amendment would operate to deny a deduction for taxes related to 2 successive years, a deduction would be disallowed for those taxes related to the later of such years. The amendment provides that any taxes for which a deduction is disallowed would be deemed to accrue in the succeeding taxable year. In order to prevent a deduction from being disallowed in certain cases where present law properly allows a doubling of deductions, the amendment would be limited to those cases where the accrual of more than 1 year's taxes in 1 taxable year is made possible by action of the taxing authority which causes the accrual events for 2 different years' taxes to occur with 1 taxable year. This amendment would be effective for taxable years ending after December 31, 1959. The amendment would direct that no inference as to existing law be drawn from its enactment.

SECTION 4. TO ALLOW THE PAYMENT OF A GROUND RENT AS A DEDUCTION, AND TO PROVIDE THAT THE FAIR MARKET VALUE OF A REDEEMABLE GROUND RENT SHALL BE TAKEN INTO ACCOUNT AS AN AMOUNT REALIZED ON A SALE OR OTHER DISPOSITION

Present law

In Maryland and Pennsylvania private homes have often been sold subject to so-called "ground rents." A ground rent is an obligation assumed by the home buyer to pay a fixed amount per year to the former owner of the property. For more than 30 years Treasury regulations and rulings have treated the sales of property subject to redeemable ground rent arrangements as sales subject to mortgages with the value of the ground rent included in the sales price in the same way as a mortgage. The annual "rents" were deductible as interest by the home buyer, and the home buyer was also permitted to deduct the taxes he paid on the property.

Problem

In 1956 the Fourth Circuit Court of Appeals held in *Estate of Ralph W. Simmers* (231 F. 2d 909, affirming 23 T.C. 869) that a person retaining a ground rent is the actual owner of the property and that, therefore, a builder who sold houses subject to ground rents would not have to include the fair market value of the ground rents in the same way as mortgages would have been included. This reasoning is, of course, contrary to the realities of the transaction. While in formal legal theory the holder of the ground rent is the owner of the land, in actual practice this ownership is a pure security device and the home buyer pays the taxes, cares for the property, and in every way acts like an owner who has bought property subject to a mortgage. Nevertheless, the Tax Court has recently followed the *Simmers* decision in *Welsh Homes, Inc.* (32 T.C. No. 22).

In view of these decisions rejecting the view that a ground rent arrangement is essentially the same as a mortgage transaction, the Internal Revenue Service will be required, unless remedial legislation is obtained, to deny many homeowners the annual deduction of ground rents as "interest" and will also be required to deny, at least in part, the deduction for real estate taxes paid on their homes. This will not only diminish the usefulness of ground rent arrangements as a form of real estate transaction, but is manifestly unfair to those persons who purchased homes subject to ground rents believing that they would be treated as owners for income tax purposes under well-established Treasury practice.

Solution

To correct the adverse effect created by the court decisions mentioned, the amendment would restore the old practice. The amendment would not, however, have the result of taxing any person on the same gain twice or permit any gain to escape all taxation. For these reasons the amendment provides that—

(1) In all sales that take place hereafter a ground rent will be treated as a mortgage;

(2) A builder who sold a home before the statute and reported the transaction as if he had retained the ownership of the land (either in a return or in a claim for refund) will not be permitted to increase his basis for the ground rent to the basis he would have acquired if he had included it as part of his sale price;

(3) A builder who sold a home and reported the ground rent retained as part of the sale price received by him will have as a basis for the ground rent the amount so taken into account in the sale price; and

(4) In order to avoid confusion it should be made clear that one who acquired property subject to a ground rent before the date of the statute will include the liability assumed in his basis for the property.

Section 5. Income Derived by a Foreign Central Bank of Issue From U.S. Obligations

Present law

Section 892 of present law exempts from tax the income of foreign governments. Section 881 of present law exempts from tax interest received from bank deposits in the United States by any foreign corporation not engaged in trade or business within the United States. In addition, section 861 exempts from taxation income derived by a foreign central bank of issue from bankers' acceptances.

A "foreign central bank of issue" is defined under existing regulations as a bank which is by law or government sanction the principal authority, other than the government itself, issuing instruments intended to circulate as currency, and is generally the custodian of the banking reserve of the country.

Problem

The U.S. income of a "foreign central bank of issue" arises primarily from three sources, namely, (1) interest on bank deposits, (2) bankers' acceptances, and (3) interest from bonds or other obligations of the United States. Where a foreign central bank of issue is a part of the government, it is exempt from tax on all its income, including the three sources previously mentioned.

However, where a foreign central bank is incorporated, and therefore an entity separate and apart from the foreign government, even though wholly government owned, it is exempt from tax on only two forms of its income. It is exempt from tax on interest received on bank deposits in the United States, like any foreign corporation not engaged in trade or business within the United States. In addition it is exempt from tax on income from bankers' acceptances by virtue of section 861. With respect to income from bonds or other obligations of the United States, these banks are probably subject to tax on this income.

Thus, a foreign central bank of issue may or may not be taxed on its interest from bonds or other obligations issued by the United States, depending entirely upon the form of organization of the foreign central bank.

Many foreign central banks are organized as a separate corporation or entity apart from the government, somewhat along the lines of our own Federal Reserve bank. The uncertain tax status of interest on U.S. obligations has affected materially the sale of U.S. obligations to these foreign central banks. Treasury bills are a desirable form of investment for foreign central banks, and there would seem to be no sound reason to make bank deposits and bankers' acceptances more attractive to foreign central banks than Government securities.

Solution

The bill adds a new section 895 to the Internal Revenue Code of 1954, with respect to taxable years beginning after December 31, 1959, to exclude from the gross income of a foreign central bank of issue the income from obligations of the United States owned by such foreign central bank, unless such obligations are owned for, or used in connection with, the conduct of commercial banking functions or other commercial activities.

This exemption would apply to securities held in connection with central banking functions and not in connection with commercial banking. The objective of this differentiation is to avoid giving any preferential treatment to the commercial activities of a Government instrumentality as compared with a private enterprise carrying on similar activities.

The revenue effect of this proposal is negligible because the income from the holdings of banks which can now qualify under section 892, including interest income from U.S. Government obligations, is already exempt, and in other cases the interest in question is exempt from tax in accordance with a general reciprocal exemption provision of an income tax convention. In addition, a substantial portion of the dollar assets owned by foreign central banks presently takes the form of time deposits and bankers' acceptances, the income from which is also exempt under present law.

Section. 6. Subchapter R—Election of Certain Partnerships and Proprietorships To Be Taxed as Domestic Corporations

A. EFFECT OF TRANSFERRING ASSETS FROM AN ELECTING PARTNERSHIP OR PROPRIETORSHIP TO A CORPORATION

Present law

Subchapter R (sec. 1361) of the 1954 Code gives certain partnerships and proprietorships an election to be taxed as though they were domestic corporations. Once an election is made, the enterprise is, in general, treated as a corporation for income tax purposes.

Problem

In practice, many partnerships and proprietorships, after making the election, find it advisable to form an actual corporation to which the assets of the electing enterprise (i.e., the partnership or proprietorship) are transferred in return for all of the stock in the corporation.

The present provisions of subchapter R do not expressly spell out the tax consequences that are to govern this transfer. On the contrary, they provide that an electing enterprise shall not be considered a corporation, and that the proprietors or partners of such enterprise shall not be considered as shareholders, for purposes of parts III and IV of subchapter C of chapter 1 (relating to corporate organizations and reorganizations).

Where such an electing enterprise transfers its assets to an actual corporation in exchange for its stock, a problem arises as to how to treat the transfer for income tax purposes. If the enterprise had in fact been a corporation (rather than simply being treated as one by reason of sec. 1361) the transaction would qualify as a tax-free reorganization. As such, neither the enterprise nor the owners thereof would be required to recognize any gain arising from the exchange of the assets of the enterprise for the stock of the corporation. Further, the transferee corporation would be deemed to have stepped into the "tax shoes" of the transferor. Consequently, the various tax attributes of the transferor, such as the earnings and profits, and the basis for the assets transferred, would carry over to the transferee. This approach, however, is not applicable to an unincorporated organization electing to be treated as a corporation since the present statute (sec. 1361(m)) specifically provides that the various reorganization rules of the 1954 Code are not applicable. As a result, the proposed regulations of the Treasury Department provide for a tax on this transfer.

More specifically, they provide that prior to the transfer the enterprise is deemed to have distributed its assets to the proprietors or partners in a liquidation and that the latter subsequently transferred the assets to the actual corporation. This view of the transaction would require the proprietors or partners of such an enterprise to pay a tax on any gain they may have had on this assumed liquidation. The gain would be measured by the difference between the fair market value of the assets received from the enterprise and the basis (i.e., the tax cost) of their interest in the enterprise.

Prior to the issuance of the proposed regulations many proprietors or partners of an unincorporated enterprise that had previously made the election under section 1361 transferred the assets of the enterprise to an actual corporation in the belief that the transfer was tax free. In some cases, the proprietors or partners would have difficulty paying the tax imposed on the assumed liquidation out of their own funds and therefore may have to cause taxable distributions from the corporation to be made to them. As a result, the Treasury Department received a number of protests to the position it has taken in the proposed regulations.

On the other hand, as a result of the inapplicability of the reorganization provisions, the transfer from an electing enterprise to an actual corporation may be treated as tax free only at the cost of creating a serious loophole, for it would mean that the electing enterprise could, by making such a transfer, eliminate free of tax any accumulated earnings or profits that may have existed immediately before the transfer.

The dilemma facing the Treasury Department is that one of the two possible positions open to it under the present statutory provisions would create a loophole by not requiring the tax attributes, including the earnings and profits, of the electing enterprise to be carried over to the actual corporation, and the other would impose an undue or at least an unexpected tax liability on the partners or proprietors of the electing enterprise if liquidation is assumed to occur prior to the transfer to the actual corporation.

Solution

The solution in the bill is an amendment to the statute which would allow the transaction described above to be treated as a tax-free reorganization. This treatment would require that the various attributes, including the earnings and profits, of the enterprise be carried over to the actual corporation and thus prevent the loophole that otherwise is possible, and at the same time avoid the imposition of any tax on any assumed liquidation by not indulging in any assumption that there was such a liquidation.

Since many taxpayers heretofore transferred assets of such an electing enterprise to an actual corporation in the belief that the transfer was tax free, the amendment is made effective as though it were enacted when section 1361 was originally enacted in 1954. However, in order to assure that this early effective date would not impose any hardship on taxpayers, it is provided that taxpayers who engaged in such a transaction in the past years be given the opportunity to revoke the election under section 1361 if this change in the statute for the past years should prove detrimental to them.

B. TIME FOR MAKING THE ELECTION UNDER SECTION 1361

Present law

Present law permits taxpayers to make the election under section 1361 at any time prior to the expiration of 60 days after the end of the first taxable year to which the election is to apply. For example, an eligible partnership or proprietorship wishing to make an election to be taxed as a corporation for the calendar year 1961 could make the appropriate election to do so as late as February 1962.

Problem

The retroactive effect of the election creates some difficult problems. For example, the delay in the election has made it difficult for the Government and the taxpayer to determine with sufficient accuracy the assets of the proprietorship or partnership that are considered to have been "transferred" to the enterprise that is to be taxed as a "corporation" and consequently to be governed by the provisions of section 1361, since the election, once made, is effective from the very beginning of the taxable year for which it is made. Whether particular assets are or are not part of the enterprise taxed as a corporation is important in determining whether there has been a withdrawal of those assets from the enterprise under circumstances giving rise to dividends. Many disagreements on this question have arisen between taxpayers and internal revenue agents.

In addition, it appears questionable policy to allow taxpayers to have the benefit of a year's hindsight in determining whether or not to make the election.

Solution

The amendment provides that taxpayers be required to make the election under section 1361 within a 2-month period that includes the last month of the preceding taxable year and the first month of the current taxable year for which the election is to be applicable. For example, an eligible partnership or proprietorship wishing to make an election to be taxed as a corporation for the calendar year 1961 would have to make the appropriate election in December 1960, or in January 1961. This is the same period of time in which taxpayers are required to make an election under the new provisions of subchapter S, which allows shareholders of certain corporations to be taxed directly on the income of the corporation. This amendment would have the effect of making the time period within which the election under subchapters R and S are to be made consistent with one another. An early election would minimize the problems now arising by reason of the retroactive effect of a long delayed election. The amendment would be prospective only.

SECTION 7. PERSONAL HOLDING COMPANIES—DEDUCTION FOR DEFICIENCY DIVIDENDS

Present law

Section 541 of the 1954 Code imposes a special tax on "undistributed personal holding company income" of personal holding companies. This special tax is in addition to other taxes and amounts to 75 percent of the "undistributed personal holding company income" not in excess of $2,000, and 85 percent of the "undistributed personal holding company income" in excess of $2,000.

"Undistributed personal holding company income" of a personal holding company—the base upon which the special tax is imposed—is defined to mean taxable income, with certain adjustments, less a deduction for dividends paid during the taxable year. Moreover, the law permits an additional deduction to a personal holding company for the amount of "deficiency dividends" where the taxpayer's liability for personal holding company taxes has been established by means of a "determination."

Deficiency dividends are dividends paid by the taxpayer within 90 days after a "determination" of its liability for personal holding company taxes and before the filing of the necessary claim for the deduction. Any overpayment resulting from the allowance of a deduction for deficiency dividends is credited or refunded to the taxpayer.

Problem

In a case where the original "determination" of the taxpayer's liability for personal holding company taxes is made by the Tax Court, any further litigation to resolve any dispute arising from a subsequent partial or complete disallowance by the Internal Revenue Service of the deduction for deficiency dividends would seem to be barred by the provisions of section 6512 (relating to limitations in the case of a petition to the Tax Court). Litigation to resolve any such dispute is not barred, however, where the original "determination" of the taxpayer's liability for personal holding company taxes is made in a formal closing agreement or an informal agreement with the Treasury.

Further litigation to resolve any such disputes was not barred under the 1939 Code. As a result, the taxpayer under the 1939 Code could further litigate, in the Court of Claims or in the district court, the correctness of a disallowance by the Internal Revenue Service of the deduction for deficiency dividends even though the original "determination" of the taxpayer's liability for personal holding company taxes was made by the Tax Court. In effect, the taxpayer, under these circumstances, was given an opportunity, under the 1939 Code, to have his day in court on this particular question. This was done by specific language contained in section 506(b) of the 1939 Code which exempted this type of case from the operation of section 322(c) of the 1939 Code, corresponding to section 6512 of the 1954 Code. This language was omitted from section 547 of the 1954 Code, apparently inadvertently.

Solution

The bill amends section 547(b)(2) of the 1954 Code by the insertion of appropriate language which would restore the right of the taxpayer to litigate the disallowance of the deduction for deficiency dividends even though the original "determination" of liability for personal holding company taxes was made by the Tax Court. The effect of this amendment would be to give the taxpayer an opportunity to have his day in court to resolve any dispute arising from the partial or complete disallowance by the Internal Revenue Service of a deduction for deficiency dividends.

PART II. EXCISE TAX PROVISIONS

SECTION 8. DEFINITION OF THE TERM "SOLD AT RETAIL"

Present law

Under present law, jewelry, furs, toilet preparations, and luggage are subject to retailers excise tax at a rate of 10 percent. Although the tax is levied upon the above-mentioned articles when "sold at retail," the Internal Revenue Code does not define that term.

Problem

Under the Treasury regulations, the tax applied to sales of taxable articles by a wholesaler or manufacturer if the sale was for purposes other than resale. However, in the cases of *Nathan Gellman* and *Louis Torti*, the courts of appeals for the eighth and seventh circuits, respectively, held that sales by persons who were primarily wholesalers to purchasers for further distribution (as prizes, awards, etc.) did not constitute sales at retail because the purchasers were not buying for personal use or consumption, but rather for further distribution under a profit or business motive. Following these decisions, the Treasury Department announced in November 1958 that the retailers excise taxes would not apply to sales of the above type when made by wholesalers.

The *Gellman* and *Torti* holdings result in a loss of tax revenue. Furthermore, wholesalers are given a competitive advantage, to the extent of the tax, over retailers in selling taxable articles for use by the purchaser as prizes, awards, etc.

Solution

In order that the retailers excise taxes apply equally to similar sales regardless of the level of distribution at which the sale takes place, the amendment defines the term "sold at retail." Generally, under the amendment, the term "sold at retail" is defined to mean any sale of an article subject to the 10-percent retailers excise tax except a sale to a person in the business of selling artices at wholesale or retail who purchased the article for resale by him. Excepted from this definition would be casual sales of an article by a person who is not in the business of selling any article at wholesale or at retail, and, in the case of a person in the busines of selling any article at wholesale or at retail, casual sales by such person of an article which was not purchased by him for the purpose of resale. Also excepted from the definition would be articles sold for use in further manufacture, including jewelry, if it is sold for incorporation in another article. This amendment would eliminate any competitive advantage available to manufacturers and wholesalers under the *Gellman* and *Torti* decisions and would restore the rule the Treasury has followed for many years. Also, under the amendment, there would be uniform application of tax to an article in that the article would bear the retailers tax whether it is obtained by the consumer through purchase or as a result of a prize, award, etc.

SECTION 9. DEFINITION OF CALCULATING OR COMPUTING MACHINES

Present law

Section 4191 of the Internal Revenue Code imposes a tax of 10 percent upon the sale by the manufacturer, producer, or importer of certain enumerated business machines or combinations thereof. Included among the taxable business machines are "calculating machines" and "computing machines." However, those terms are not otherwise defined in the statute.

Problem

In recent years, there have been developed electronic calculating and computing machines and systems which are capable of carrying out a number of different types of mathematical processes, as well as data storing. Many of the functions performed by these new machines or systems are the same as those performed by business machines which are unquestionably subject to tax. To that extent, the machines or systems are a substitute for and competitive with installations of a number of separate individual machines. Furthermore, the technological growth in this field of electronic office equipment creates uncertainty as to whether the code provisions adequately define all of the equipment subject to tax.

Originally, some of these new machines or systems were held to be nontaxable for the reason that they were primarily designed and used for scientific or research purposes. Gradually, however, these machines or systems have been adapted for extensive business and office use to perform functions comparable to functions performed by individual machines specifically named in section 4191. Moreover, these new systems, in increasing numbers, are being purchased in place of machines clearly subject to tax.

Solution

Because doubt exists as to the taxable status of some of these machines or systems, section 4191 of the Internal Revenue Code would be amended prospectively to specifically tax these electronic computing or calculating machines and systems. The amendment accomplishes this by defining the terms "calculating machines" and "computing machines" to include calculating and computing machines, data processing machines, or systems, including machines or equipment for furnishing information to the system and producing or reproducing information derived from the system in any type or form, regardless of size or design. This would serve to remove any distinction between the old machines covered in present law and the new electronic machines, in addition to preventing a loss of substantial revenue as the use of these new machines becomes more prevalent.

SECTION 10. IMPORTATION OF AUTOMOBILES

Present law

Section 4061(a) of the code imposes an excise tax of 10 percent on automobiles, trucks, buses, etc., when "sold by the manufacturer, producer, or importer." Section 4218(a) makes the tax applicable when the article subject to tax is used by the manufacturer, producer, or importer, other than in the further manufacture of an article subject to a manufacturers' excise tax.

Problem

Since present law provides that the tax is due only when an importer sells an imported automobile, as a practical matter, the Internal Revenue Service experiences considerable difficulty in collecting the tax. One reason is that the importer often is a "dummy" corporation formed for the sole purpose of importing foreign automobiles over a short period of time. After the automobiles are sold the corporation disappears with all its assets, leaving the district director with no means of collecting the tax. Similar problems are experienced in connection with foreign nationals, who solicit orders for foreign automobiles in this country, and foreign export corporations which have selling subsidiaries in this country which arrange for sales of foreign automobiles to U.S. purchasers. Because of the manner in which many of these transactions are arranged it is often difficult to identify the true importer; moreover, if the foreign corporation or its selling subsidiary is found to be the importer, collection of the tax is practically impossible.

A further problem has arisen in the case of automobiles imported into the United States by individual residents of the United States who (A) purchase them by mail order from foreign dealers; (B) take them from a bonded warehouse in Canada and drive them across the border; or (C) purchase them as an incident to a journey abroad. In accordance with Treasury regulations the individual importer in these cases incurs no liability for tax with respect to an automobile which he "incidentally * * * imports for his personal use." Many of these automobiles imported for personal use are resold at once in accordance with plans made or intentions conceived before the importation. This is in violation of regulations but enforcement is both difficult and expensive.

Because of these activities widespread avoidance and evasion of the excise tax on automobiles exist in this area. Moreover, established distributors and dealers importing automobiles for resale in this country are placed at a serious competitive disadvantage as a result of such avoidance and evasion.

Solution

The best way to deal with these problems is by insuring collection at the time of entry through customs. Therefore, the bill amends the Internal Revenue Code by adding a new section 4064 to require a bond of all importers for sale (or business use), conditioned on payment of the tax, unless the district director is satisfied that the importer has paid such taxes in the past and will do so in the future; and by precluding release of the automobiles from customs custody except where a bond has been given, or is not required. The importer for personal use must make payment of the tax before the article is released from customs custody.

Under the bill, automobiles would not be released from customs custody until one of the following conditions is met: (1) The importer for sale (or business use) furnishes the collector of customs with a statement showing that he has given sufficient bond to protect the Government's interests, or (2) the importer for sale (or business use) furnishes the collector of customs with a statement showing that he is not required to give a bond, or (3) the importer for personal use pays the tax to the collector of customs.

PART III. ADMINISTRATIVE PROVISIONS

SECTON 11. MODIFICATION OF FILING REQUIREMENTS FOR DECLARATIONS OF ESTIMATED INCOME TAX BY INDIVIDUALS

Present law

Section 6015 provides that, for an individual with no more than $100 of gross income from sources other than wages or salaries, a declaration is required if his gross income is expected to be more than $5,000; however, no declaration is required by a married person if the gross income of the married person and his spouse is expected to be not more than $10,000, nor from a head of a household or a surviving spouse if his gross income is expected to be not more than $10,000. For an individual with more than $100 of income not subject to withholding, a declaration is required if his gross income from all sources is expected to be more than $600 per exemption plus $400.

Problem

Under these provisions, approximately 1.7 million declarations that report either small liabilities or no liabilities to pay estimated tax are filed annually. In 1958, out of the 5.7 million declarations filed, 1.1 million, or one-fifth of the total, reported no estimated tax and 600,000 declarations reported small amounts of estimated tax. Eliminating nontaxable declarations and reducing the number of declarations from low-income taxpayers would result in a substantial saving to both the Government and the taxpayers.

Solution

The bill would amend section 6015 so that a declaration will not be required in any case in which the estimated tax liability is less than $40. It is expected that this change would substantially reduce the number of declarations filed each year.

Because of this new minimum amount for filing declarations, it is felt that the present filing requirements with respect to income not subject to withholding will become unrealistic in that many taxpayers with nonwithheld income between $100 and $200 and within the minimum amounts of income from wages subject to withholding, would ordinarily not be required to file declarations because their estimated tax liability would be less than $40. To avoid the filing of declarations by low-income taxpayers, the bill raises the $100 nonwithheld income limitation to $200.

To simplify the filing requirements even further, the gross income test of $400 plus $600 times the number of exemptions is eliminated. Under this change, the only test for the filing of declarations by taxpayers with income not subject to withholding would be whether or not the tax is in excess of $40. It is believed that most taxpayers who at present are not required to file a declaration because of the gross income test will continue to be exempt under the $40 limitation.

SECTION 12. INCLUSION OF THE SELF-EMPLOYMENT TAX IN THE ESTIMATED TAX

Present law

Section 6017 of the 1954 Code provides that every individual who has $400 or more of net earnings from self-employment shall make an annual return of such earnings on form 1040 for social security purposes, even though he may not have sufficient income to require the filing of an income tax return. Under present law a taxpayer is not required to take into account his social security self-employment tax in computing his estimated income tax. However, inclusion of the estimate of self-employment tax in the declaration of estimated income tax is authorized under the regulations, but this is voluntary on the part of taxpayers.

Problem

Recent increases in the self-employment tax rate and tax base, and future rate increases scheduled under law, will result in larger amounts of self-employment tax owed by taxpayers from year to year. In 1950, when the self-employment tax was first enacted, the maximum tax per individual was nominal ($81) and no provision seemed necessary for including this tax in the estimated tax. Since then the maximum tax has been increased to $216 per year for 1960 through 1962. Increases will occur until 1968, when the maximum tax will have reached $324. As a result, many taxpayers will find it increasingly difficult to meet such tax liabilities in annual lump-sum payments when their income tax returns are filed.

Solution

In the interest of insuring the collection of the self-employment tax and making it easier for the taxpayer by spreading his self-employment tax payments, the bill amends the code to require taxpayers to include the tax on self-employment income in computing their estimated tax. Under the bill, self-employed taxpayers would be required to file declarations and make quarterly payments in advance only if their combined income and self-employment tax liability for the taxable year exceeded $40.

Although, under the bill, the inclusion of self-employment tax in the estimated tax would bring in approximately 1.2 million declarations from self-employed persons who do not file now, it is anticipated that this would be more than compensated for by the expected elimination of most of the 1.7 million nontaxable declarations and declarations with small amounts of estimated tax filed under the current requirements.

Since self-employed taxpayers already are required to estimate their anticipated income for purposes of complying with the requirements for filing declarations of estimated income tax, it is not expected to be too burdensome on these taxpayers to require them at the same time to estimate their employment tax liability.

SECTION 13. PLACE FOR FILING TAX RETURNS

Present law

Section 6091 of the 1954 Code provides that returns of tax by a taxpayer other than a corporation shall be filed in the internal revenue district in which is located the legal residence or principal place of business of the person making the return, or, if he has no legal residence or principal place of business in any internal revenue district, then at such place as may be prescribed by regulations. Such section also provides that returns of tax by a corporation shall be filed in the internal revenue district in which is located the principal place of business or principal office or agency of the corporation, or, if it has no principal place of business or principal office or agency in any internal revenue district, then at such place as may be prescribed by regulations.

Problem

The International Operations Division of the Service was established to carry out better and more uniform enforcement of the revenue laws in the case of certain American citizens who are outside the United States, individuals and domestic corporations claiming benefits for income derived outside of the United States, nonresident aliens, and foreign corporations. This Division is handicapped in its operations because the inflexible rules of section 6091 preclude the direct filing of returns from such persons with this Division.

Solution

The bill amends section 6091 to provide that the Secretary or his delegate may prescribe by regulations the place where the returns of these taxpayers must be filed. Specifically, section 6091(b)(1) is amended to provide that tax returns of citizens of the United States whose principal place of abode for the taxable year is outside the United States, tax returns of individuals who claim the benefits of section 911 (relating to earned income from sources without the United States), and sections 931 and 933 (relating to income from sources within possessions of the United States), and tax returns of nonresident alien individuals shall be filed at such places as may be prescribed by regulations. The bill also amends section 6091(b)(2) to provide that tax returns of foreign corporations, and tax returns of domestic corporations which claim the benefits of section 922 (relating to the special deduction for Western Hemisphere trade corporations), section 931, or section 941 (relating to the special deduction for China Trade Act corporations), shall be filed at such places as may be prescribed by regulations.

Under these amendments, the Service could require "foreign" returns to be filed with the International Operations Division and thus could eliminate the present cumbersome and roundabout procedure under which certain returns are filed with the various districts and are then transferred to that Division. This would facilitate, as well as result in economies in, the processing and handling of these returns.

Section 14. Modification of Provision Requiring District Directors To Maintain for Public Inspection Lists Containing the Name and Post Office Address of Each Person Filing an Income Tax Return in the District

Present law

Section 6103(f) of the Internal Revenue Code requires the Secretary or his delegate, as soon as practicable each year, to prepare and make available to public inspection, in the district directors' offices, lists containing the name and post office address of each person making an income tax return in that district. Section 7213 (a)(1) makes it unlawful for any officer or employee of the United States to make known in any manner whatever not provided by law information contained on Federal income-tax returns.

Problem

In order to comply with the provisions of sections 6103(f) and 7213(a)(1) of the code, a separate index card containing only the name, address, and account number of the taxpayer is prepared and filed alphabetically. These indexed cards have also been used by the Service to locate a taxpayer's return, filed according to account number.

However, since 1954 when the punchcard form 1040A was adopted, those districts serviced with automatic punchcard machines have not been preparing index cards for 1040A returns. Instead, the punchcard form 1040A returns are alphabetized and filed with the form 1040 index cards. For the purpose of locating a 1040A return, this arrangement has the added advantage of eliminating the intermediate step of consulting an index card. Although the assembled index cards maintained before the advent of the punchcard form 1040A met the statutory requirements, it is likely that the system of filing the form 1040A punchcard returns with the form 1040 index cards does not, since the 1040A returns may not be made available for public inspection.

Seldom is anyone interested in inspecting the entire list of taxpayers filing returns; rather, persons are usually interested in determining whether a particular individual filed a return for a specific year. This information could be obtained from the District Director's regular processing files, which are not open to public inspection, and furnished by his office to the inquirer.

Solution

In the interest of simplifying the procedure for and reducing the cost of maintaining and supplying the information most usually requested by the public. The bill amends section 6103(f) to require only that the Secretary or his delegate answer inquiries as to whether specifically identified persons have filed income tax returns. The amendment would further require the District Director, when called upon, to furnish the inquirer with a statement as to whether the records of his office show the specifically identified person did or did not file an income tax return in his district and the post office address for such person as shown on the return if a return was filed.

Section 15. Issuance of Statutory Deficiency Notices

Present law

Section 6213(a) of present law provides that a deficiency in any income, estate, or gift tax may not be assessed until a notice of deficiency has been mailed to the taxpayer and the 90-day period (150-day period for persons outside the country) for filing a petition with the Tax Court has expired. However, a number of exceptions to this restriction on assessment are provided. For example, assessment without a notice of deficiency may be made in the case of mathematical errors, excessive tentative carryback allowances, and payments of tax before assessment.

Problem

It is beneficial to both the taxpayer and the Government to properly dispose of as many cases as possible at the administrative level, in view of both the expense involved in litigation and the crowded docket of the Tax Court. Accordingly, the Service has instituted procedures for handling deficiency cases before issuance of the 90-day notice required by law. These procedures are designed to give taxpayers ample opportunity to discuss and protest proposed adjustments to their taxes before their cases reach the Tax Court.

In the case of office audits, these procedures are as follows: (1) The revenue agent first discusses a proposed adjustment with the taxpayer. (2) If the taxpayer does not agree to the proposed adjustment, the Service issues a so-called 15-day letter advising the taxpayer of the nature and amount of the proposed adjustments and informing him of his right to discuss the matter in an informal conference. (3) If he does not respond to this 15-day letter or if no agreement is reached during an informal conference, a 30-day letter is issued. It advises him of the proposed adjustments and his right to a conference with the appellate division. (4) If there is no response to the 30-day letter or if no agreement is reached at the appellate division conference, the statutory 90-day deficiency notice is issued. Substantially the same procedures are followed in field audit cases.

Many taxpayers who have no intention of objecting to the proposed adjustments of their taxes or of petitioning the Tax Court do not respond to the 15-day, 30-day, or 90-day notices. They simply wait to receive a bill for their taxes (which cannot under present law be assessed until after the expiration of the 90-day period) before taking any positive steps to settle their additional tax liability.

Failure to respond to the notices issued by the Service is expensive and time-consuming for both the taxpayer and the Government. The taxpayers are subject to interest at the rate of 6 percent during this entire period. The Government, on the other hand, has the expense of preparing numerous notices in the interest of disposing of as many cases as possible at the administrative level; yet, the statute requires that a 90-day notice be issued before an assessment can be made. Moreover, the preparation of these 90-day notices is much more time-consuming than the preparation of the 15-day and 30-day notices in that the 90-day notice serves, in essence, as the basis for the Government's brief in the Tax Court. Thus, this notice must be more exacting in form and legal precision than the other notices.

Solution

Under the bill the above procedure would be modified in cases where it appears that a taxpayer is not interested in the formal conferences afforded him by the Service or the privilege of going to the Tax Court. Under this amendment, the procedures outlined above in (1), (2), and (3) would still apply; namely, the discussion with the taxpayer, the right to conferences, the 15-day and 30-day notices. In addition, under this amendment the 30-day letter would be sent to the taxpayer by certified mail.

This 30-day statutory notice would contain a statement to the effect that unless the taxpayer notifies the Service within 30 days that he (*a*) wishes to protest the proposed deficiency or (*b*) desires a 90-day letter to be issued so that he may file a petition with the Tax Court, the deficiency will be assessed. Under this amendment if the Service receives no answer to the 30-day letter, it could then assess the tax without the formality and expense involved in issuing the 90-day letter. Likewise, this would mean the taxpayer who is just waiting to receive a bill would have less interest to pay. This amendment would not in any way reduce the opportunities presently available to taxpayers who desire conferences with the Service or the privilege of having their cases heard by the Tax Court.

This amendment further contains a provision to relieve hardships. It is recognized that in certain instances, e.g., extended vacations or illness, the 30-day notice may not give a taxpayer sufficient time in which to notify the Service of his intention to either protest the proposed deficiency or to go to the Tax Court. Accordingly, if within 60 days after the expiration of the 30-day notice the taxpayer shows reasonable cause for his failure to answer, the assessment will be disregarded for all purposes. The taxpayer will be treated as having answered the 30-day letter within the proper time. Thus, in cases of hardship, this amendment would allow a taxpayer 90 days from the issuance of the 30-day notice in which to answer the Service.

Section 16. Claiming a False of Fraudulent Deduction for Exemption To Be Treated as a Misdemeanor Rather Than a Felony

Present law

Section 7201 of the Internal Revenue Code makes it a felony for any person willfully to attempt in any manner to evade or defeat any tax imposed by the code. Section 7207, on the other hand, makes it a misdemeanor for any person willfully to deliver or disclose to the Secretary or his delegate any list, return, account, statement, or other document known by him to be fraudulent or to be false as to any material matter.

Problem

Section 7207 of the 1954 Code is based, in part, upon section 3616(a) of the Internal Revenue Code of 1939, which, in turn, was ultimately derived from the Revenue Act of 1798. In *Achilli* v. *United States* (1957) 353 U.S. 373, the Supreme Court held that section 3616(a) of the 1939 Code did not apply to income taxes. Although section 7207 of the 1954 Code differs in some respects from section 3616(a), both the Senate Finance Committee and the House Ways and Means Committee reports relating to H.R. 8300 (which was enacted as the Internal Revenue Code of 1954) state that section 7207 "contains no material change from existing law." This statement in the committee reports results in some doubt as to whether section 7207 is applicable in income tax cases. In view of this doubt, the Government is no longer bringing prosecutions under section 7207 and does not consider that section to be a useful enforcement tool. It may be added that if section 7207 is applicable to cases involving income taxes, that section would then overlap to some extent section 7201 of the 1954 Code, which makes it a felony to attempt to evade or defeat tax. This overlap could create problems in criminal tax prosecutions. See the decisions in *Berra* v. *United States* (1956) 351 U.S. 131, and *Achilli* v. *United States*, *supra*.

Solution

(1) Under the bill section 7207 is repealed. This would mean, however, that there will be no misdemeanor provision available to prosecute the so-called "small tax evasion" case.

(2) Since approximately 75 percent of the "small tax evasion" cases involve the claiming of a false or fraudulent deduction for exemption, the bill amends section 7205 (relating to fraudulent exemption certificates) by adding a new subsection. This new subsection would specifically make it a misdemeanor for any individual to willfully claim in his income tax return any false or fraudulent deduction for exemption under section 151. Because of the number of such offenses and the relatively small amount of evaded tax which they involve, the enforcement program would be improved if a misdemeanor provision, rather than a felony, were available for the prosecution of these cases. This provision would contain a penalty of not more than $500, or imprisonment for not more than 1 year, or both. This amendment is applicable to offenses committed after the date of its enactment. Certain minor amendments are also made to conform other provisions of the statute to the above-described changes and to continue the present 6-year period for commencing a prosecution.

Section 17. Period of Limitations for Commencing Suits for Refund

Present law

Present law provides that no suit for refund can be maintained in any court unless there has first been filed with the Secretary or his delegate a claim for refund which meets the requirements as to timeliness of filing, form, content, etc. (sec. 7422(a)). Once a timely and sufficient claim for refund has been filed, a suit for refund may be commenced 6 months after the filing of the claim (unless the Commissioner renders a decision thereon within that time) but not more than 2 years from the date on which the Secretary or his delegate mails, by certified or registered mail, a notice of disallowance of the claim (sec. 6532(a)(1)).

Problem

There is no provision in the Internal Revenue Code which limits the period for filing a suit for refund where the claim is not disallowed. The lack of any provision expressly limiting the period for filing a suit for refund where the claim for refund is not formally disallowed frequently places the Government in the difficult position of having to defend a suit for refund, filed long after the year to which the suit relates, at a time when witnesses, tax returns and other necessary documentary evidence may not be available. Although the power of the Commissioner to issue a statutory notice of disallowance of a claim carries with it the power to start the running of the 2-year period of limitations for filing a suit for refund, this power is not always sufficient to protect the Government from having to defend against suits based on stale claims.

The inadequacy of the power to start the running of the 2-year period of limitations by issuing a statutory notice of disallowance is particularly acute in the case of the so-called "informal claim."

In such a case, the taxpayer files a document—such as a letter—which clearly does not meet the requirements established by regulations as to the essentials of a claim, but which is nevertheless held by a court, in subsequent litigation, to be a claim which is sufficient for the purposes of satisfying the requirements for commencing a suit for refund. In such instances, the Commissioner, being unaware that the document is intended to be a claim for refund, may never issue a statutory notice of disallowance, with the result that the period of limitation for filing a suit for refund never starts running.

Solution

The bill amends section 6532 of the code to require that a suit for refund be commenced within a period of 6 years from the date of filing of the claim for refund to which the suit relates, or within a period of 2 years from the date of mailing of the statutory notice of disallowance (or the date of filing of the waiver specified in section 6532(a)(3)), whichever period expires first. This limitation would be subject to the exception that where the taxpayer and the Secretary or his delegate agree, pursuant to section 6532(a)(2) to extend the period for filing suit, the taxpayer would be permitted to file suit within the period agreed upon.

Moreover, this amendment would become effective 1 year after the date of enactment. This would have the effect that in the case of claims for refund filed on or before the date of enactment, the period for commencing suit for refund be no less than 1 year after the date of enactment (except in those cases where the period for filing suit as permitted by a limitation other than the 6-year limitation would expire prior to 1 year after the date of enactment).

Section 18. Timely Mailing Treated as Timely Filing Extended to Returns

Present law

Section 7502 of present law provides that if any claim, statement, or other document (except certain tax returns or other documents required under chapter 61, relating to information and returns) is received after the day on which it is required to be filed, it will nevertheless generally be considered as filed on time if the postmark shows a date on or before the due date. A registry receipt is prima facie evidence of delivery. In other words, timely mailing is timely filing for all documents but certain tax returns. This rule was first placed in the tax laws in the 1954 code.

Problem

In 1954, the Internal Revenue Service took the position that the "timely mailing" rule should not apply to returns on the grounds that this might impose too great an administrative burden upon the Service. At that time, the "timely mailing" rule was a new concept and the Service had had no experience with this type of provision. With approximately 60 million returns being filed yearly, the Service was fearful that if the "timely mailing" rule was applied to returns and any unforeseen problems developed with the new rule, it might cause numerous additional burdens.

These fears soon proved unfounded. Since the only reason for the exception in present law, namely, the Service's fear of excessive administrative burdens, is no longer valid, it is believed that the law should be amended to eliminate this exception to the "timely mailing" rule.

Solution

The bill amends section 7502 to make tax returns and other documents under chapter 61 subject to the "timely mailing" rule.

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