DESCRIPTION OF

MISCELLANEOUS TAX BILLS

(H.R. 5573, H.R. 5470, H.R. 2597, H.R. 3191, H.R. 3581, H.R. 4577, and H.R. 4948)

Scheduled for Markup

on July 12, 1982

By the

Subcommittee on Select Revenue Measures

of the

Committee on Ways and Means

Prepared by the staff

of the

Joint Committee on Taxation

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INTRODUCTION

This document includes a summary and a description of the seven miscellaneous tax bills scheduled for markup on July 12 by the Ways and Means Subcommittee on Select Revenue Measures.

The bills are the following:

(1) H.R. 5573 -- Rules for charitable contributions of technological equipment to schools;

(2) H.R. 5470 -- Exclusion from gross income of certain payments for personal injury damages;

(3) H.R. 2597 -- Membership requirements for tax-exempt veterans organizations;

(4) H.R. 3191 -- Expenses of attending conventions on domestic cruise ships;

(5) H.R. 3581 -- Exclusion of certain foreign commodity income as foreign personal holding company income;

(6) H.R. 4577 -- Retroactive effective date for restricted property provision; and

(7) H.R. 4948 -- Extension of cash and deferred plan rules to salary reduction arrangements under money purchase pension plans.

In the summary section of the document, there are indications of possible amendments for the bills.

Summary of Miscellaneous Bills

(1) H.R. 5573—Messrs. Stark, Shannon, Bafalis, Gephardt, Holland, Rangel, Archer, and others

Special One-Year Rules for Charitable Contributions of Technological Equipment to Primary and Secondary Schools

Under present law, the amount of charitable deduction allowed for a contribution of ordinary-income property (such as a donation of inventory by a manufacturer) is limited, subject to certain exceptions, to the donor's cost basis in the property (sec. 170(e)). Also under present law, the maximum charitable deduction allowed to a corporation in one year for the total amount of its contributions is 10 percent of the corporation's taxable income for the year, with a five-year carryover of any excess.

The bill would provide special deduction rules for a charitable contribution by a corporation of a computer, or other sophisticated technological equipment, to a primary or secondary school for use directly in the education of students.

Under the bill, a deduction would be allowed for the sum of the donor's cost basis in the property plus 50 percent of the difference between the property's fair market value and basis, but not to exceed twice the basis. Also, the bill would increase, to up to 30 percent of taxable income, the limitation on the aggregate amount deductible in one year by a corporate donor on account of such contributions.

The special charitable deduction rules under the bill would apply to qualifying donations of computers or other sophisticated technological equipment only if made within one year after enactment of the bill.

Proposed modifications to H.R. 5573

1. The definition of equipment qualifying for favorable treatment under the bill is modified to provide a precise definition of computers, display screens, and installation equipment.

2. The requirement that the contribution be made no later than two years after the equipment is constructed is shortened to six months.

3. Restrictions are added to assure that the donor does not limit its contributions solely to wealthy schools or a narrow geographical area.

4. The amendment deletes the provision which would have raised the current 10 percent cap on deduction of corporate charitable contributions to 30 percent for qualified computer contributions.

5. Language is added requiring that the contribution be made by a taxpayer who is in the business of making and selling the donated computer or computer equipment. Also, a donation of computer display screens or installation equipment may qualify only if given with the computer.

(2) H.R. 5470—Messrs. Jacobs, Holland, Guarini, Duncan, and Vander Jagt [1]

Exclusion from Gross Income of Certain Payments for Personal Injury Damages

Present law excludes from gross income certain types of compensation payments for personal injuries or sickness, including damages received under a suit or settlement of a claim, amounts received from accident and health insurance, and certain disability income allowances (sec. 104). The Internal Revenue Service has ruled that damages for personal injury are excludable from gross income under section 104 whether paid as a lump sum, or paid in periodic payments out of a fund invested and owned by the tortfeasor or an insurer.

The bill would expand the types of compensation payments for personal injuries which are listed in section 104 as excludable from gross income specifically to include amounts received by an assignee of an obligation to pay personal injury damages and used by the assignee to satisfy that obligation. Also, the bill would statutorily adopt the rulings position of the Revenue Service that the section 104 exclusion applies to certain periodic payments, by the tortfeasor or the assignee, of damages for personal injuries or sickness. Finally, the bill would amend section 162 (deduction for trade or business expenses) to provide expressly that the assignee may deduct under that section the amount of damages paid during the year.

The provisions of the bill would be effective for taxable years ending after 1981.

Possible amendment

The revised proposal would provide for the following:

(1) Periodic damage payments received on account of personal injuries or sickness would be excluded from the plaintiff's income (notwithstanding that there could be an interest element to the payments).

(2) A lump sum payment of damages by a tortfeasor to an assignee would be excluded from the income of the assignee to the extent that the payment is used to fund an obligation to make periodic payments of damages to the plaintiff.

(3) The basis of any property purchased by the assignee to fund the obligation to make periodic payments of damages would be zero.

(4) Income from investments in any one year that exceed the amount required to fund the periodic payment for that year would be includible in the assignee's income.

(5) Amounts used to fund periodic damage payments would be deductible by the assignee.

Revenue effect

Under the revised proposal, the revenue effect is estimated to be negligible.

(3) **H.R. 2597—Messrs. Jones (of Okla.), Conable, Guarini, Bailey (of Pa.), Anthony, and Frenzel, and others**

Membership Requirements for Tax-Exempt Veterans Organizations

Under present law, a post or organization of war veterans may qualify for exemption from income tax if at least 75 percent of its members are war veterans, and substantially all of the other members are veterans, cadets, or spouses (or widows or widowers) of war veterans, veterans, or cadets (Code sec. 501(c)(19)). For this purpose, a war veteran is any person, whether or not a present member of the Armed Forces, who served in the U.S. Armed Forces during a period of war (including the Korean and Vietnam conflicts).

The bill would broaden the income tax exemption for veterans organizations so that it applies to otherwise qualifying organizations if at least 75 percent of the organization's members are present or past members of the U.S. Armed Forces, and substantially all of its other members are cadets or spouses (or widows or widowers) of past or present members of the Armed Forces or of cadets. The provisions of the bill would apply to taxable years beginning after the date of enactment.

(4) H.R. 3191—Messrs. Guarini. Bafalis Gephardt, Matsui, and Heftel, and others

Tax Treatment of Expenses of Attending Conventions on Domestic Cruise Ships

Under present law, no deduction is allowed for expenses of attending a convention, seminar, or similar meeting on a cruise ship, whether the ship sails within or outside U.S. territorial waters (Code sec. 274(h)(2)).

The bill would provide that business expenses for attending a convention, seminar, or similar meeting on a cruise of a domestic cruise ship would be deductible to the same extent as other business expenses (rather than being subject to disallowance under sec. 274(h)) if all the ports of call of the cruise are within the "North American area" (the United States, its possessions, Canada, Mexico, or the Trust Territory of the Pacific Islands). The bill would apply to expenses of such cruise ship conventions beginning after 1981.

Possible amendment

An amendment would disallow any deduction for cruise meeting expenses unless the taxpayer justified the deduction by written statements signed by him and by an officer of the sponsoring group and by any other methods prescribed by regulations. The taxpayer would have to establish the direct relation of the meeting to his income-producing activity, the U.S. registry of the cruise vessel, and the limitation of the cruise to the North American area (the United States, its possessions, Canada, Mexico, and the Trust Territory of the Pacific Islands).

(5) H.R. 3581—Mr. Russo

Exclusion of Certain Foreign Commodity Income as Foreign Personal Holding Company Income

Under present law, dividends received by a foreign corporation which is controlled by U.S. shareholders are considered foreign personal holding company income and as such may be taxable to the U.S. shareholders. The fact that the underlying income of the paying corporation is not taxable to the U.S. shareholders does not relieve the dividend from being holding company income.

Under the bill, dividends received by a controlled foreign corporation from a related controlled foreign corporation will not be considered foreign personal holding company income if 80 percent of the gross income of the corporation paying the dividends was derived from the purchase or sale of agricultural commodities not grown in the United States in commercially marketable quantities.

Possible amendment

A possible amendment is a limited non-Code amendment that would exclude from foreign personal holding company, and thus from the U.S. tax under the subpart F provisions of the Code, dividends received by a foreign subsidiary acquired by the Consolidated Foods Corporation.

(6) H.R. 4577—Mr. Coelho

Retroactive Effective Date for Restricted Property Provision (sec. 252) of the Economic Recovery Tax Act of 1981

Under present law rules (Code sec. 83), property transferred in connection with the performance of services (e.g., to an employee) is not taxed at the time of transfer if the property is subject to a substantial risk of forfeiture and is nontransferable. As amended by section 252 of the Economic Recovery Tax Act of 1981 (ERTA), section 83 provides that stock is treated as subject to a substantial risk of forfeiture and nontransferable (and hence is not taxable on receipt) if the stock is subject to the "insider trading" rule of section 16(b) of the Securities Exchange Act of 1934.

The amendments to section 83 made by section 252 of ERTA apply to taxable years ending after December 31, 1981. Under the bill, these amendments would apply to taxable years ending after June 30, 1969, i.e., all taxable years to which section 83 applies. The bill also provides that the amendments made by section 252 of ERTA would apply to taxable years beginning before January 1, 1984 only if the person to whom stock was transferred so elects.

This amendment is presently intended to benefit three individuals -- Fred T. Franzia, John G. Franzia, Jr. and Joseph S. Franzia.

Possible amendment

An amendment could limit the proposal to the situation involving the three intended beneficiaries.

(7) H.R. 4948—Mr. Matsui

Extension of Cash and Deferred Plan Rules to Salary Reduction Arrangements Under Money Purchase Pension Plans

The Employee Retirement Income Security Act of 1974 (ERISA) provided that amounts deferred by an employee pursuant to a cash or deferred arrangement under a tax-qualified profit-sharing, stock bonus or money purchase pension plan are excluded from the employee's income if (1) the plan was in existence on June 27, 1974, and (2) the applicable requirements of prior law were satisfied. This tax treatment for existing plans was preserved, pending study by the Congress of the appropriate treatment for cash or deferred arrangements.

Under the Revenue Act of 1978, amounts deferred by an employee after 1979 pursuant to a cash or deferred arrangement under a tax-qualified profit-sharing or stock bonus plan are excluded from the employee's income only if certain requirements added by the Act are met. No rules were provided by the 1978 Act for cash or deferred arrangements under money purchase pension plans.

Under the bill, amounts deferred by an employee pursuant to a salary reduction arrangement under a money purchase pension plan would be excluded from the employee's income if the plan was in existence on June 27, 1974, and contributions by employees and by the employer do not exceed the levels permitted under the plan's contribution formula on that date. In addition, the plan would be required to satisfy rules added by the 1978 Act with respect to employee participation and prohibited discrimination in favor of officers, shareholders, or highly compensated employees. The bill would apply to money purchase pension plans maintained by taxable employers or tax-exempt organizations. The bill generally would apply retroactively for plan years beginning after 1980, and to contributions made after that date.

Description of Miscellaneous Bills

(1) H.R. 5573—Messrs. Stark, Shannon, Bafalis, Gephardt, Holland, Rangel, and Archer, and others

Special One-Year Rules for Charitable Contributions of Technological Equipment to Primary and Secondary Schools

Present law

General reduction rule

A taxpayer generally may deduct, within certain limitations, the amount of cash or the fair market value of other property contributed to qualified charitable organizations. However, the amount of charitable deduction otherwise allowable for donated property generally must be reduced by the amount of any ordinary income which the donor would have realized had the property been sold for its fair market value at the date of the contribution (Code sec. 170(e)).[1] Thus, a donor of appreciated ordinary-income property (property the sale of which would not give rise to long-term capital gain) generally may deduct only the donor's basis in the property, rather than the fair market value. For example, a manufacturer which donates a product from its inventory generally may deduct only its inventory cost for the item.

Special rules for certain corporate contributions

Under present law, charitable contributions by corporations of two types of ordinary-income property, if donated to certain exempt organizations for specified purposes, are subject to a different reduction rule.

The first exception, enacted in the Tax Reform Act of 1976, is for corporate donations of ordinary-income property to a charitable organization to be used solely for care of the needy, the ill, or infants (such as donations by the producer or manufacturer of food, clothing, or medical equipment), where such use is related to the donee's charitable functions (sec. 170(e)(3)). The second exception, enacted in the Economic Recovery Tax Act of 1981, is for corporate donations of newly manufactured scientific equipment to a college or university to be used for research (or research training) in the United States in the physical or biological sciences (sec. 170(e)(4)).

In the case of a charitable contribution of inventory which qualifies under one of these exceptions, the corporate donor generally is allowed a deduction equal to the sum of its basis in the property plus one-half of the unrealized appreciation (i.e., the difference between fair market value and basis). However, in no event is a deduction allowed for

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[1] In the case of donations of tangible capital gain property, the amount taken into account as a charitable contribution must be reduced by a portion of the appreciation if the use of the donated item by the donee charity is unrelated to the charity's exempt functions, or if the property is given to certain types of private foundations.

an amount in excess of twice the basis of the property (sec. 170(e)(3)(B)).

These two exceptions were enacted because the Congress concluded that it was desirable to provide a larger tax incentive than would be available if the general reduction rule applied for charitable contributions by corporations of certain ordinary-income property to specified types of charities for particular purposes. At the same time, the Congress also determined that the deduction so allowed should not be such that the donor could be in a better after-tax situation by donating the property than by selling it.

Overall deduction limitation

The total charitable deduction allowed to a corporation is limited to 10 percent of the corporation's taxable income (computed with certain adjustments) for the year in which the contributions are made. (This limitation was raised from five percent by the Economic Recovery Tax Act of 1981.) If the amount contributed exceeds the percentage limitation, the excess may be carried forward and deducted over five succeeding years, subject to the percentage limitation in those years.

Issues

1. The first principal issue is whether contributions by a business to schools for use in educating students where there could be a benefit to the donor (e.g., through increasing a market for its products) should be treated for income tax purposes as charitable contributions (in which case a charitable deduction may be allowed for an amount in excess of the cost basis of the donated item), or as noncharitable promotional expenditures (in which case the deduction would be limited to the item's cost to the donor).[2]

2. If such contributions are to be treated as charitable contributions, the second principal issue is whether an exception to the general reduction rule applicable to charitable contributions of inventory should be made in the case of qualifying contributions of computers, etc.; i.e., should any deduction in excess of the cost of the goods to the donor be allowed, and if so, how much. Related issues are (a) what kinds of property should be eligible for any special treatment (for example, should all types of sophisticated technological equipment be eligible or only computers, and if so limited, how qualifying computers should

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[2] In *Singer Co.* v. *U.S.*, the U.S. Court of Claims upheld IRS denial of charitable deductions claimed by a manufacturer for the amount of discounts allowed on purchases of sewing machines by schools and colleges (449 F.2d 413) (Ct. Cl. 1971)).

In that case, the court had found that the school discounts were offered "for the predominant purpose of encouraging [the schools] to interest and train young women in the art of machine sewing, thereby enlarging the future potential market by developing prospective purchasers of home sewing machines and, more particularly, Singer machines—the brand on which the future buyers learned to sew." The court concluded that the manufacturer's predominant reason for granting such discounts was other than charitable, notwithstanding that the company said it would have provided the discounts even if it had a total monopoly of the sewing machine market, and even though a company survey showed that fewer than two percent of its regular retail customers had been influenced in buying by previous school training. Since the company expected a return in the nature of future increased sales, the court concluded that the company received a *quid pro quo* for the discounts which was substantial and was therefore inconsistent with allowing charitable deductions.

be defined); (b) whether any special treatment should be accorded to all taxpayers, or limited (for example) to manufacturers; and (c) whether any special treatment should be limited to taxpayers which actually construct the donated property.

3. The third principal issue is whether, in the case of such contributions, the limitation on the aggregate charitable deduction allowed in one year to a corporation should be increased above the general 10 percent limitation.

Explanation of the bill

Overview

The bill would provide a larger charitable deduction (than would be allowed under the general reduction rule), and would increase the general limitation on the aggregate amount of corporate contributions deductible in a year, for charitable contributions by corporations of computers or other sophisticated technological equipment, if contributed to a primary or secondary school, and if used by the school directly in the education of students. These special charitable deduction provisions would apply only to qualifying donations which are made within one year after enactment of the bill.

The principal intended beneficiary of the bill is Apple Computer, Inc. The provisions of the bill would also benefit any other corporate taxpayer which, during the one-year period following enactment of the bill, makes qualifying charitable contributions of computers or other sophisticated technological equipment.

Requirements for favorable treatment

In order for the special deduction rules of the bill to apply, there must be a charitable contribution (as defined under sec. 170(c)) by a corporation [3] which satisfies the following requirements:

(1) The donated property is a computer or other sophisticated technological equipment or apparatus, and is tangible personal property of an inventory nature (within the meaning of sec. 1221(1));

(2) The property is donated to an educational organization (described in sec. 170(b)(1)(A)(ii))[4] other than an institution of higher education (as defined in sec. 3304(f));[5]

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[3] The bill would not apply in the case of a corporation which is a subchapter S corporation (as defined in sec. 1371(b)); a personal holding company (as defined in sec. 542); or a service organization (as defined in sec. 414(m)(3)).

[4] An educational organization is described in sec. 170(b)(1)(A)(ii) "if its primary function is the presentation of formal instruction and it normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on. The term includes institutions such as primary, secondary, preparatory, or high schools, * * *" and includes both public and private schools (Reg. § 1.170A-9(b)(1)).

[5] An institution of higher education, as defined in sec. 3304(f), means an educational institution which (1) admits as regular students only individuals having a certificate of graduation from a high school, or the recognized equivalent of such a certificate; (2) is legally authorized to provide a program of education beyond high school; (3) provides an educational program for which it awards a bachelor's or higher degree, provides a program which is acceptable for full credit toward such a degree, or offers a program of training to prepare students for gainful employment in a recognized occupation; and (4) is a public or other nonprofit institution.

(3) The contribution is made within two years of substantial completion of construction of the property,[6] and within one year after the enactment of the bill;

(4) The original use of the donated property is by the school;

(5) All the use of the donated property by the school is directly in the education of students in the United States;

(6) The donated property is not transferred by the school in exchange for money, other property, or services; and

(7) The donor receives a written statement from the school representing that the use and disposition of the donated property will be in accordance with the last two requirements.

Allowable deduction

If all the conditions are satisfied, the charitable deduction allowed by the bill generally would be for the sum of (1) the taxpayer's basis in the property, plus (2) one-half of the unrealized appreciation (i.e., one-half of the difference between the property's fair market value[7] determined at the time of the contribution and the donor's basis in the property). However, in no event would a deduction be allowed for any amount in excess of twice the basis of the property.

For example, if a manufacturer makes a qualifying contribution to a high school of a computer with a cost basis of $\$5X$, and a fair market value of $\$16X$, the bill would allow the manufacturer a charitable deduction of $\$10X$ (twice the $\$5X$ basis). Assuming a 46 percent tax bracket, the effect of the deduction under the bill would be to reduce the manufacturer's tax liability by $\$4.6X$, or 92 percent of the cost of manufacture. The out-of-pocket cost of the donation to the manufacturer, exclusive of distribution and other expenses, would then be $\$0.4X$, or 8 percent of the manufacturer's cost. If in the example the fair market value of the computer was $\$11X$, the deduction would be $\$8X$ ($\$5X$ basis plus ½ of the $\$6X$ difference between value and basis), and the out-of-pocket cost to the manufacturer would be $\$1.32X$ ($\$5X$ cost less $\$3.68X$ tax benefit).

Increased overall limitation

The bill also would provide that the limitation on the aggregate charitable contribution deduction allowed to a corporation (under present law, 10 percent of taxable income, computed with certain adjust-

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[6] Unlike the special deduction rule of present law for qualifying contributions to colleges or universities of scientific research equipment (sec. 170(e)(4)), the rule provided under the bill would not require that the donated computer, etc., is constructed by the donor. For purposes of the present-law rule for scientific research equipment donations, property is to be treated as constructed by the taxpayer only if the cost of parts (other that parts manufactured by the taxpayer or a related person) used in construction do not exceed 50 percent of the taxpayer's basis in the property (sec. 170(e)(4)(C)).

[7] Where donated property is of a type which the taxpayer sells in the course of its business, the fair market value is the price which the taxpayer would have received if the taxpayer had sold the contributed property in the usual market in which it customarily sells, at the time and place of the contribution and, in the case of a contribution of goods in quantity, in the quantity contributed. The usual market of a manufacturer or other producer consists of the wholesalers or other distributors to or through whom it customarily sells, but if it sells only at retail the usual market consists of its retail customers (Reg. § 170A-1(c)(2)).

ments) would be increased by the amount of the taxpayer's qualifying contributions of computers or other sophisticated technological equipment. However, the limit as so increased could not exceed 30 percent of taxable income (as computed with certain adjustments).

Effective date

The provisions of the bill would apply to taxable years ending after the date of enactment. The special deduction rules provided under the bill would apply only to qualifying contributions which are made within one year after enactment.

Revenue effect

(to be supplied)

(2) H.R. 5470—Messrs. Jacobs, Holland Guarini, Duncan, and Vander Jagt [1]

Exclusion from Gross Income of Certain Payments for Personal Injury Damages

Present law

In general, present law (Code sec. 104) excludes from gross income the following types of compensation payments for personal injuries or sickness:

(1) certain amounts received under worker's compensation laws (if paid for personal injuries or sickness);

(2) damages received under a suit or settlement of a claim;

(3) amounts received through accident and health insurance (unless received by an employee and either attributable to employer contributions that were not includible in the gross income of the employee, or else paid directly by the employer);

(4) pensions, annuities, or similar allowances for personal injuries or sickness resulting from active service in the armed forces of any country, the Coast and Geodetic Survey, or the Public Health Service, or a disability annuity paid under the Foreign Service Act; and

(5) amounts received as disability income by a United States employee who was injured by terrorist violence while performing official duties outside the United States.

However, to avoid a double tax benefit, an exclusion is not allowed for such compensation payments to the extent attributable to (and not exceeding) deductions allowed to the recipient as medical expenses in a prior year.

Generally, the Internal Revenue Service has ruled that damages for personal injury are excludable from gross income under section 104 whether paid as a lump sum. or paid in periodic payments out of a fund invested and owned by the tortfeasor or an insurer (see Rev. Rul. 77-230, 1977-2 C.B. 214; [2] Rev. Rul. 79-220, 1979-2 C.B. 74; [3] and

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[1] H.R. 5470 is generally identical to H.R. 4356 (Messrs. Goldwater and Rousselot) and H.R. 5732 (Mr. Holland), except that the latter two bills would be effective for taxable years ending after 1980.

[2] Rev. Rul. 77-230 holds that distributions from a trust established and owned by the United States under a settlement agreement stemming from an individual's suit for injuries sustained at a government facility, and requiring payment of the individual's future medical expenses from the income or corpus of the trust, are excludable from the individual's gross income. Under the facts of the ruling, any trust assets (accumulated income or corpus) remaining on the individual's death would revert to the government.

[3] Rev. Rul. 79-220 holds that where the insurer of a tortfeasor purchases and retains exclusive ownership of a single-premium annuity contract to fund specified monthly payments for a fixed period pursuant to settlement of a damage suit for personal injuries, the recipient may exclude from his or her gross income the full amount of the payments, and not merely the discounted present value. The taxpayer's only right with respect to the amount invested was to receive the monthly payments, and the ruling concluded that the taxpayer not have actual or constructive receipt or economic benefit of the amount invested.

Rev. Rul. 79–313, 1979–2 C.B. 75).[4] However, the exclusion of damages for personal injury does not apply to investment income generated from a lump-sum award invested by or on behalf of the taxpayer (Rev. Rul. 76–133, 1976–1 C.B. 34).

Issues

The principal issue is whether periodic payments of damages for personal injury, whether paid by the person originally liable for such damages or by an assignee of the tortfeasor, should, by express statutory provision, be excluded from the gross income of the recipient. Other issues are whether amounts received by an assignee to fund an obligation to pay damages in periodic payments should be excluded from gross income, and whether amounts paid by such assignee to a recipient of personal injury damages should be deductible as ordinary and necessary business expenses.

Explanation of the bill

The bill would expand the types of compensation payments for personal injuries which are specified in section 104 as excludable from gross income to include amounts received by an assignee of an obligation to pay personal injury damages and used by the assignee to satisfy that obligation.

Also, the bill would statutorily adopt the rulings position of the Internal Revenue Service that the section 104 exclusion applies to certain periodic payments of damages for personal injuries or sickness received from or through either the person originally liable for the damages or an assignee of the person originally liable. This rule would apply only if the assignee is subject to the same rights and liabilities of such person, and only if the recipient cannot accelerate, defer, increase, or decrease the periodic payments from the assignee.

Finally, the bill would amend section 162 (deduction for trade or business expenses) to provide expressly that the assignee may deduct the amount of damages paid during the year under that section.

Effective date

The provisions of the bill would be effective for taxable years ending after 1981.

Revenue effect

Under the revised proposal (see summary section), the revenue effect is estimated to be negligible.

[4] Rev. Rul. 79–313 holds that if, in a personal injury settlement, the insurer of a tortfeasor agrees to make 50 consecutive annual payments (increasing by five percent a year), the entire amount of the payments received is excludable from the recipient's gross income under sec. 104(a)(2). The taxpayer did not have any right to accelerate or modify the amount of payments, and the insurer was not required to set aside specific assets to secure any part of its obligation. The ruling concluded that the taxpayer did not have actual or constructive receipt, or economic benefit, of the present value of the damages.

(3) H.R. 2597—Messrs. Jones (of Okla.), Conable, Guarini, Bailey (of Pa.), Anthony, and Frenzel, and others

Membership Requirements for Tax-Exempt Veterans Organizations

Present law

Under present law, a post or organization of war veterans may qualify for exemption from income tax under Code section 501(c)(19). To qualify for this exemption, (1) the organization must be organized in the United States or any of its possessions; (2) at least 75 percent of its members must be war veterans, and substantially all of the other members must be veterans, cadets, or spouses (or widows or widowers) of war veterans, veterans, or cadets; and (3) no part of the net earnings of the organization can inure to the benefit of any private shareholder or individual. For this purpose, a war veteran is any person, whether or not a present member of the Armed Forces, who served in the United States Armed Forces during a period of war (including the Korean and Vietnam conflicts).

In addition, a special exemption from the tax on unrelated business income is provided to such organization with respect to amounts received in connection with payments of life, sick, accident, or health insurance for members or their dependents, so long as the income from such activity is set aside to provide such benefits or is set aside for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals (sec. 512(a)(4)).

Issue

The issue is whether the income tax exemption for veterans organizations should be expanded to include organizations of past or present members of the U.S. Armed Forces as well as organizations of war veterans.

Explanation of the bill

The bill would amend section 501(c)(19) to provide income tax exemption for an otherwise qualifying organization of past or present members of the Armed Forces of the United States. The organization would satisfy the membership test for exemption if at least 75 percent of its members are past or present members of the U.S. Armed Forces, and if substantially all of the other members are cadets or spouses (or widows or widowers) of past or present members of the U.S. Armed Forces or of cadets.

Effective date

The provisions of the bill would be effective for taxable years beginning after the date of enactment.

Revenue effect

It is estimated that the bill would reduce budget receipts by less than $5 million annually.

(4) H.R. 3191—Messrs. Guarini, Bafalis, Gephardt, Matsui, and Heftel, and others

Tax Treatment of Expenses of Attending Conventions on Domestic Cruise Ships

Present law

In general

Under present law, a deduction is allowed for the ordinary and necessary expenses of carrying on a trade or business or income-producing activity (Code secs. 162, 212), including transportation expenses and amounts for meals and lodging while away from home in pursuit of a trade or business or income-producing activity. Transportation expenses are deductible if the principal purpose of the trip is for business purposes. Meals and lodging expenses (other than lavish and extravagant expenditures) are deductible if they are allocable to a business purpose. Generally, therefore, a deduction is allowed for the cost of attending a convention or seminar in pursuit of a trade or business or income-producing activity.

Special rules (sec. 274(h)) are provided for travel expenses for attendance at conventions, seminars, or similar meetings if held outside the United States, its possessions, Canada, Mexico, or the Trust Territory of the Pacific Islands (the "North American area") [1] or if held on a cruise ship. (Conventions, etc. held outside the North American area are commonly referred to as "foreign conventions".) The section 274(h) rules apply both to expenses paid by individuals attending such conventions and also to expenses paid by employers of such individuals.

Under section 274(h)(1), no deduction is allowed for the expenses of attending a foreign convention unless, taking certain factors into account, it is as reasonable to hold the meeting outside the North American area as within it. Under section 274(h)(2), no deduction is allowed for the expenses of attending any convention, etc. held on a cruise ship, even if the ship is sailing entirely within U.S. territorial waters.

Background

Special rules for foreign conventions were first enacted in 1976 because of the proliferation of foreign conventions, seminars, and cruises that were ostensibly held for business or educational purposes, but which appeared to the Congress to be vacations in disguise. Under pre-1976 law, the allowance of deductions for such trips depended on a subjective determination of the taxpayer's principal

[1] Under the United States-Jamaica income tax treaty, deductions are permitted for expenses of attending a convention in Jamaica (Art. 25(7)). Thus, Jamaica is, in effect, treated for this purpose as within the North American area.

purpose in making the trip. This had proved to be a difficult standard for the Internal Revenue Service to apply, particularly in the case of overseas trips.

Under the rules as initially adopted in 1976, deductions could be taken for no more than two foreign conventions per year, and were limited to certain transportation and subsistence expenses. However, the 1976 rules proved to be unsatisfactory because, in addition to imposing burdensome reporting requirements, those rules in some cases operated to disallow legitimate business travel expenses while in other cases failed to disallow deductions for trips which actually were foreign vacations.[2]

Accordingly, the rules were revised by the Congress in 1980 (P.L. 96-608). The present "as reasonable" rule was intended to focus on the reason why a foreign site was selected for the convention or meeting. The disallowance of deductions for expenses of attending conventions, etc. on cruise ships was justified on the ground that the personal benefits of going on a cruise often predominate over business purposes. Therefore, it was argued, disallowing deductions for such expenses avoids disputes on audit and prevents taxpayers from claiming deductions that would not be upheld by a court. On the other hand, it was argued that denying deductions for conventions held on all cruise ships would disadvantage the U.S. cruise ship industry.

Issue

The issue is whether the expenses of attending a convention, seminar, or similar meeting held on a cruise of a U.S. cruise ship should be deductible if all the ports of call of the cruise are within the North American area.

Explanation of the bill

Under the bill, a convention, seminar, or similar meeting held on a cruise of a domestic cruise ship would be treated as held in the North American area if all the ports of call of the cruise are within the North American area. Thus, business expenses for attending such a meeting would be treated the same as other business expenses. For example, transportation expenses would be deductible if the principal purpose of the trip is for business, and meals and lodging expenses would be deductible to the extent they are allocable to a business purpose and are not lavish or extravagant. A domestic cruise ship would be defined as a cruise ship documented under the laws of the United States.

Under the bill, no deduction would be allowed for expenses of attending a convention, seminar, or other meeting held on a cruise ship which is not a domestic cruise ship.

Effective date

The amendments made by the bill would apply to expenses allocable to conventions, seminars, and meetings beginning after December 31, 1981.

Revenue effect

It is estimated that the bill would have a negligible effect on budget receipts.

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[2] Sen. Rept. No. 96-1031, 96th Cong., 2d Sess. (1980), at p. 12.

(5) H.R. 3581—Mr. Russo

Exclusion of Certain Foreign Commodity Income as Foreign Personal Holding Company Income

Present Law

In the Revenue Act of 1962, Congress enacted legislation intended to tax certain income of tax haven corporations established by U.S. taxpayers. Before this legislation a U.S. taxpayer could engage in business outside the United States through a foreign tax haven corporation and not pay U.S. tax on that income until the corporation paid a dividend to the U.S. shareholder.

Under legislation enacted in 1962 (secs. 951 through 964), U.S. shareholders of controlled foreign corporations are subject to current taxation on their proportionate share of certain categories of undistributed profits from tax haven activities and other activities of the controlled foreign corporation. Foreign taxes paid on that income can be credited against any U.S. tax imposed. This income ("subpart F income") includes certain sales income where the property is sold to or purchased from a related person. It also includes foreign personal holding company income. Dividends and other passive income are conidered foreign personal holding company income. Generally, a dividend received by a controlled foreign corporation is treated as subpart F income taxable to the U.S. shareholders even if the paying corporation's income is not subpart F income.

In 1976, these anti-tax haven provisions were amended to exclude from taxation income of a controlled foreign corporation from the sale of agricultural commodities which are not grown in the United States in commercially marketable quantities.

Issues

The issue presented is whether dividend income of a foreign subsidiary of a U.S. corporation should be excluded from the general rule treating dividends as personal holding company income taxable to the subsidiary's U.S. parent because the distributing corporation's income is not taxed to the U.S. parent because it is from the sale of agricultural products not grown in the United States in commercially marketable quantities.

Explanation of the Bill

Dividends received by a controlled foreign corporation from a related controlled foreign corporation 80 percent of the gross income of which is derived from the purchase or sale of agricultural commodities which were not grown in the United States in commercially marketable quantities will not be considered foreign personal holding company income. Thus, if these agricultural products are purchased and sold by a controlled foreign corporation and that corporation pays a dividend to a related controlled foreign corporation, the dividend will not be considered foreign personal holding company income and will not be subject to U.S. taxation.

It is understood that Consolidated Foods is the primary beneficiary of this amendment although other similarly situated taxpayers could be affected.

Effective Date

The provisions of the bill would apply to taxable years of controlled foreign corporations which begin on or after January 1, 1980 and will also apply to taxable years of U.S. shareholders within which or with which the taxable years of the controlled foreign corporation end.

Revenue Effect

On the basis of information available to the committee staff, it is estimated that this bill would have no effect on budget receipts during the next five fiscal years, although there may be annual reductions in tax liabilities of less than $5 million annually during this period.

We understand that the taxpayer we know about would oppose an assertion by the IRS that the dividend distributions in question are in fact taxable. Consequently, there would be an effect on budget receipts only if the taxpayer's position were not sustained by the Court.

There may be other taxpayers which may benefit from this bill. If the relevant transactions are large, the revenue impact might be sustantial.

(6) H.R. 4577—Mr. Coelho

Retroactive Effective Date for Restricted Property Provision (sec. 252) of the Economic Recovery Tax Act of 1981

Present law

In general

Under the present law rules relating to transfers of property in connection with the performance of services (Code sec. 83), an employee generally includes in income the fair market value of transferred property, less any amount paid for the property, when the property first becomes either transferable or not subject to a substantial risk of forfeiture.[1] Thus, if an employee receives property that is both subject to a substantial risk of forfeiture and is not transferable, the employee generally is not taxed until the property becomes either transferable or not subject to a substantial risk of forfeiture. The amount the employee includes in income is equal to the fair market value of the transferred property (as of the time of taxation), less any amount the employee paid for the property.

However, an employee may elect (under sec. 83(b)) to be taxed when the property is received.[2] In that case, the employee includes an amount in income equal to the fair market value of the property when received less any amount paid for the property.

Effect of restrictions

Generally, under section 83, restrictions on property are not taken into account in determining the fair market value of the property. Also, property is considered transferable for purposes of section 83 when the property would not be subject to a substantial risk of forfeiture in the hands of a subsequent transferee.

Prior to enactment of section 252 of the Economic Recovery Tax Act of 1981 (ERTA), the U.S. Tax Court had ruled [3] that stock subject to the "insider trading" rules of section 16(b) of the Securities Exchange Act of 1934 [4] was transferable within the meaning of section 83. Thus, although the taxpayer's profit on a sale of the stock within six months of receipt could be recovered by the corporation, the taxpayer was taxable on the fair market value of the stock when received.

As amended by section 252 of ERTA, section 83 provides that stock subject to the restrictions of section 16(b) of the Securities Exchange Act of 1934 is treated as being subject to a substantial risk of forfeiture and nontransferable for the six-month period following re-

[1] An employer generally is allowed a business expense deduction when the employee is taxed, equal to the amount includible in the employee's income (sec. 83(h)).

[2] See note 1.

[3] *Horwith* v. *Comm'r*, 71 T.C. 932 (1979).

[4] 15 U.S.C. § 78p(b).

ceipt of the stock during which that section applies. Thus, unless the taxpayer elects (under sec. 83(b)) to be taxed when the stock is received, the taxpayer must include in income (and the employer may deduct) at the expiration of the period during which section 16(b) is applicable, the value of the stock at such time, less any amount the taxpayer paid for the stock. A similar rule is provided for stock subject to restrictions on transfer by reason of complying with the "pooling-of-interests" accounting rules of Accounting Series Releases Numbered 130 ((10/5/72) 37 FR 20937; 17 CFR 211.130)) and 135 ((1/18/73) 38 FR 1734; CFR 211.135)).

The amendments made to section 83 by section 252 of ERTA apply to taxable years (of the transferee) ending after December 31, 1981.

Issue

The principal issue is whether taxpayers should be allowed to elect to have the amendments made by section 252 of ERTA apply retroactively.

Explanation of the bill

Under the bill, the amendments to section 83 made by section 252 of ERTA would apply to taxable years ending after June 30, 1969, i.e., to all taxable years to which section 83 applies. However, in the case of any taxable year beginning before January 1, 1984, the amendments made by section 252 of ERTA would not apply unless the taxpayer to whom the stock was transferred makes an election to have such amendments apply to such taxable year. The election would have to be made in the manner prescribed by the Treasury Department.

Effective date

The bill would be effective on enactment. The amendments made by the bill would apply to taxable years ending after June 30, 1969.

Revenue effect

It is estimated that the bill would reduce receipts by less than $5 million annually.

(7) H.R. 4948—Mr. Matsui

Extension of Cash and Deferred Plan Rules to Salary Reduction Arrangements Under Money Purchase Pension Plans

Background and present law

In general

A money purchase pension plan is a defined contribution plan under which each participant's pension benefit is based solely on the balance of the participant's account, consisting of contributions, income, gain, expenses, loss, and forfeitures allocated from the accounts of other participants.[1] Profit-sharing plans are also defined contribution plans.

Under a cash or deferred profit-sharing plan, or under a money purchase pension plan with a salary reduction arrangement, the employer gives an employee the choice of (1) receiving a specified amount in cash as current compensation or (2) having that amount contributed to the plan.

In December 1972, the Internal Revenue Service issued proposed regulations which called into question the tax treatment of cash or deferred profit-sharing plans and money purchase pension plans with salary reduction arrangements. (These proposed regulations were withdrawn in July 1978). Under the rules in effect at the time of the proposal, an employee generally was not taxed currently on amounts the employee chose to have contributed to a tax-qualified cash or deferred profit-sharing plan or salary reduction money purchase pension plan. Under the proposed regulations, amounts contributed to a plan due to the election of the employee would be included in the employee's income.

Freeze on tax treatment

In order to allow time for Congressional study of this area, the Employee Retirement Income Security Act of 1974 (ERISA) provided that the tax treatment of contributions to cash or deferred profit-sharing plans or salary reduction money purchase plans in existence on June 27, 1974 was to be governed under the law as it was applied prior to January 11, 1972. Accordingly, employer contributions to these cash or deferred profit-sharing plans were not includible in the income of covered employees, provided the plans satisfied the requirements of pre-1972 law and otherwise complied with the tax-qualification rules. Under ERISA, this freeze in tax treatment was continued through 1976, or (if later) until regulations were issued in final form which would change the pre-1972 administration of the law. The freeze was subsequently extended through 1979.

[1] Under a defined benefit pension plan, a participant's benefit is specified independently of an account for contributions, etc. (e.g., an annual benefit of two percent of average pay for each year of employee service).

Revenue Act of 1978

The Revenue Act of 1978 provided rules for new and old profit-sharing plans with cash or deferred arrangements. The new rules, which also apply to stock bonus plans, are effective for plan years beginning after 1979. For years beginning before 1980, the tax treatment under a plan in existence on June 27, 1974, is determined under prior law. No new rules were provided by the 1978 Act for salary reduction arrangements under money purchase pension plans.

Issue

The principal issue is whether the tax-qualification rules should permit salary reduction arrangements under money purchase pension plans on the same basis as cash or deferred arrangements are permitted under profit-sharing and stock bonus plans.

Explanation of the bill

The bill would revise the tax-qualification rules to permit a qualified money purchase pension plan which was in existence on June 27, 1974, and which provided for a salary reduction arrangement on that date, to continue the arrangement after 1979. However, the bill's revision to the tax-qualification rules would apply only to those money purchase pension plans under which employer and employee contributions may not exceed the levels (e.g., as a percentage of pay) provided under the plan's contribution formula on June 27, 1974.

In addition, for plan years beginning after 1979, a salary reduction arrangement under a money purchase pension plan would be required to meet the special tax-qualification rules for cash or deferred arrangements added by the 1978 Act with respect to employee eligibility to participate in the arrangement and to prohibited discrimination in favor of employees who are officers, shareholders, or highly compensated. These rules presently apply to cash or deferred arrangements under qualified profit-sharing or stock bonus plans.

The provisions of the bill would apply to salary reduction arrangements under money purchase pension plans of taxable employers and tax-exempt organizations.

Effective date

The bill would apply retroactively for plan years beginning after December 31, 1980, and to contributions made after that date. A transition rule is provided for contributions made after 1979, and before the beginning of the first plan year beginning after 1980.

Revenue effect

It is estimated that the bill would have a negligible effect on budget receipts.