[JOINT COMMITTEE PRINT]

DESCRIPTION OF TAX BILLS

SCHEDULED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON SELECT REVENUE MEASURES

OF THE

COMMITTEE ON WAYS AND MEANS

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INTRODUCTION

This pamphlet provides a description of six miscellaneous tax bills scheduled for a public hearing on March 24, 1980, by the Ways and Means Subcommittee on Select Revenue Measures. The first part is a summary of the bills. This is followed by a more detailed description of the six bills (in numerical order), including an indication of present law, issues involved, an explanation of the provisions of the bills, effective dates, and estimated revenue effects.

I. SUMMARY

1. H.R. 4070—Messrs. Jones and Conable

Exemption for Veterans' Organizations

Under present law, in order for certain posts and organizations to qualify for exemption from Federal income tax (under Code sec. 501(c)(190) and exemption from the unrelated business tax for insurance related income (under Code sec. 512(a)(4)), at least 75 percent of its members must be war veterans. The bill would change this test to provide that at least 75 percent of the members must be past or present members of the United States Armed Forces.

2. H.R. 4155—Mr. Simon

Disclosure of Mailing Addresses of Individuals Defaulting on Certain Student Loans

Present law authorizes the Secretary of the Treasury to disclose to the Commissioner of Education the mailing addresses of taxpayers who have defaulted on certain student loans made under the Higher Education Act of 1965 for use in locating such taxpayers and collecting the loans. However, there is no provision for the disclosure of mailing addresses of taxpayers who have defaulted on student loans made under the Migration and Refugee Assistance Act.

The bill would expand present law to allow the Secretary to disclose the mailing addresses of taxpayers who have defaulted on student loans made under the Migration and Refugee Assistance Act.

3. H.R. 4725—Mr. Rostenkowski

Printing of Airline Ticket Tax Amount

The bill would repeal the present requirement to show on an airline ticket the amount paid for transportation and the Federal excise tax on air transportation for each segment of the taxable transportation. The requirement that the ticket to show the total air fare and total tax for each trip would be retained.

4. H.R. 5124—Messrs. Lederer and Murphy (of Pa.)

Transfers of Proven Oil and Gas Properties to a Controlled Corporation

Under present law, income from oil and gas production generally is not allowed to be reduced by a deduction for percentage depletion. However, independent producers and royalty owners are allowed a percentage depletion deduction up to 1,000 barrels a day of oil and gas production. Generally, the otherwise allowable percentage depletion deduction is denied with regard to production from proven oil and gas properties which have been transferred after 1974. Such transfers, however, generally do not preclude the availability of the percentage depletion deduction if the transferee and the transferor of the property must allocate a single 1,000 barrel amount. Existing law contains no provision under which an individual shareholder and a controlled corporation may allocate a single 1,000 barrel amount in order to come within this exception to the transfer rule.

The bill would permit transfers of proven oil and gas properties to a controlled corporation, without the loss of percentage depletion, if the controlling shareholder elects to allocate the 1,000 barrels eligible for percentage depletion after the transfer with the controlled corporation.

The provisions of the bill would apply with respect to taxable years beginning after 1974. Therefore, it would allow tax refunds for calendar years 1975 through 1979 as to oil and gas production for those years.

5. H.R. 5716—Messrs. Fisher and Butler

Tax Treatment for Consolidated Return Purposes of Stock in Certain Transferor Railroads in the ConRail Reorganization

Under present law, net operating losses of a member of an affiliated group of corporations controlled by a common parent corporation may be used to offset income reported by other members of the affiliated group where consolidated income tax returns are filed by the group. In order to reflect the reduction in tax liabilities derived by the other members of the affiliated group, the basis in the loss corporation's stock owned by other members of the group is reduced by these operating losses, and, where these losses exceed basis, a negative basis (called an excess loss account) is created. The excess loss account is restored to income when the other members of the affiliated group sell their stock in the loss corporation or when the loss corporation becomes insolvent.

The bill would specify that, for purposes of the consolidated return rules, the determination of worthlessness of stock in a corporation which was a transferor railroad in the April 1, 1976, ConRail reorganization will not occur until after a final determination of the value of the transferred rail properties by a special court formed for this purpose.

The only known beneficiary of this bill is the affiliated group of corporations controlled by Norfolk and Western Railway Company, Inc. This affiliated group filed consolidated income tax returns and included Erie Lackawanna Railway Company, one of the bankrupt transferors of rail properties to ConRail in the April 1, 1976, ConRail reorganization. The Erie Lackawanna Railway Company was wholly owned by another member of the Norfolk and Western affiliated group. Its net operating losses have been used to offset income reported by other members of the group and resulted in the creation of an excess loss account. The Internal Revenue Services has indicated that this excess loss account should be restored to income for the 1976 consolidated return year of the Norfolk and Western affiliated group.

6. H.R. 5968—Mr. Duncan

Life Benefits of Voluntary Employees' Beneficiary Associations

The bill would allow tax-exempt voluntary employees' beneficiary associations described in Code section 501(c)(9) to provide for the payment of life benefits for their members through whole or term life insurance policies or otherwise.

The potential beneficiaries of this bill would be all voluntary employees' beneficiary associations. One known beneficiary would be the Army Mutual Aid Association.

II. DESCRIPTION OF BILLS

1. H.R. 4070—Messrs. Jones and Conable

Exemption for Veterans' Organizations

Present law

In 1972, Congress added a new class of organization to the types of organizations which are exempt from Federal income tax (Code sec. 501(c)(19)). That exemption applies to a post or organization of war veterans (1) which is organized in the United States or its possessions, (2) at least 75 percent of its members are war veterans, (3) substantially all of its other members are veterans, cadets or spouses (or widows or widowers) of war veterans, veterans, or cadets, and (4) no part of the net earnings inures to a private shareholder or individual. For this purpose, a war veteran is any person, whether or not a present member of the United States Armed Forces, who served in the Armed Forces of the United States during a period of war (including the Korean and Vietnam conflicts). In addition, a special exemption from the tax on unrelated business income was provided to such organizations with respect to amounts received in connection with payments of life, sick, accident, or health insurance for its 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 (Code sec. 512(a)(4)).

Issue

Under present law, at least 75 percent of a qualifying organization's members must be war veterans. Some organizations are finding it difficult to meet this requirement since the United States has not been at war for several years.

The issue is whether the exemption which was intended to be available to organizations whose primary membership is war veterans should be extended to organizations whose primary membership is past and present members of the U.S. Armed Forces.

Explanation of the bill

The bill would broaden the exemption so that it applies to otherwise qualifying organizations where at least 75 percent of its 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.

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 this bill would decrease budget receipts by less than $5 million annually.

2. H.R. 4155—Mr. Simon

Disclosure of Mailing Addresses of Individuals Defaulting on Certain Student Loans

Present law

Under present law, the Secretary of the Treasury may disclose to the Commissioner of Education the mailing address of any taxpayer who has defaulted on a loan made from the student loan fund established under part E of Title IV of the Higher Education Act of 1965 (Code sec. 6103(m)(4)). The addresses disclosed by the Secretary may be used only for the purpose of locating taxpayers who have defaulted on student loans in order to collect the defaulted amounts.

Any mailing addresses which have been disclosed to the Commissioner of Education may, in turn, be disclosed to any educational institution with which there is an agreement under part E of Title IV of the Higher Education Act of 1965. Officers, employees, or agents of such an institution, whose duties relate to the collection of student loans, may use the addresses for purposes of locating individuals who have defaulted on student loans.

Issue

The issue is whether present law should be expanded to permit the Secretary to disclose the mailing addresses of taxpayers who have defaulted on student loans made under the Migration and Refugee Assistance Act of 1962.

Explanation of the bill

The bill would authorize disclosure to the Commissioner of Education of the mailing address of any taxpayer who has defaulted on a loan made pursuant to section 3(a)(1) of the Migration and Refugee Assistance Act of 1962 to a student at an institution of higher education. The disclosure could be made only upon written request by the Commissioner of Education to the Secretary. Any mailing address disclosed under this provision could be used only for the purpose of locating the taxpayer in order to collect the loan.

Effective date

The provisions of the bill would be effective upon enactment.

Revenue effect

This bill is not expected to have any direct revenue effect.

3. H.R. 4725—Mr. Rostenkowski

Printing of Airline Ticket Tax Amount

Present law

Present law (Code sec. 7275) requires that an airline ticket show the total of (a) the amount paid for the air transportation and (b) the Federal excise tax imposed on the air transportation under Code section 4261.[1] Further, if amounts paid with respect to any segment of the air transportation are shown on the ticket, the ticket shall also show the total of the amount paid and the Federal excise tax with respect to the segments, as well as for the sum of the segments.

In addition, any advertising of taxable air transportation which states the cost of such transportation is required to state such cost as the total of (a) the amount paid for the air transportation and (b) the Federal excise tax. Where the advertising separately states the amount to be paid for the air transportation and the Federal excise tax, the advertising must show the combined total (transportation plus tax) at least as prominently as the other stated amounts, and the excise tax is to be described as "user taxes to pay for airport construction and airway safety and operations." Finally, present law provides a penalty for $100 for each violation upon conviction (as a misdemeanor).

Issue

The issue is whether air transportation tickets which show amounts paid by segments should be required to show the amounts paid and the Federal excise tax for each segment of the transporation.

Explanation of the bill

The bill would repeal the present requirement that air transportation tickets show the amount paid and the Federal excise tax for each segment of the transportation. It would retain the requirement, however, that the tickets show the total amount paid and the total amount of Federal excise tax imposed on the air transportation.

Effective date

The provisions of the bill would be effective upon date of enactment.

Revenue effect

This bill is not expected to have any direct revenue effect.

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[1] The present rate is 8 percent, which is scheduled to decline to 5 percent on July 1, 1980.

4. H.R. 5124—Messrs. Lederer and Murphy (of Pennsylvania)

Transfers of Proven Oil and Gas Properties to a Controlled Corporation

Present law

In general

Under present law, income from oil and gas production generally is not allowed to be reduced by percentage depletion. Independent producers and royalty owners, however, are permitted a percentage depletion deduction of 22 percent with respect to 1,000 barrels of oil or gas a day. Between the end of 1980, and the beginning of 1984, the rate of percentage depletion phases down from 22 percent to 15 percent; production from properties on which secondary or tertiary recovery processes are utilized remains eligible for a 22 percent rate of percentage depletion until the end of 1983, when the rate becomes 15 percent. In instances when a taxpayer has secondary or tertiary production, as well as production from primary recovery processes, the 1,000 barrel amount is allocated first to the secondary or teritary production.

Related party allocation

Present law generally requires the 1,000 barrels a day of production that are eligible for percentage depletion to be allocated among the properties owned directly by a taxpayer, and among all the properties owned by certain other persons with specified relationships to the taxpayer. For this purpose, the following persons are treated as one taxpayer, and must allocate one 1,000 barrel amount: component members of the same controlled group of corporations, businesses (including corporations, trusts, or estates) under common control, and members of the same family (including only the taxpayer's minor children and spouse). Present law, however, does not require an allocation of a single 1,000 barrel amount between a trust and its beneficiary, or between an individual and a controlled corporation. Therefore, in these latter instances, each producer has a separate 1,000 barrel amount. As a result, an individual and a controlled corporation may be eligible for percentage depletion on 2,000, rather than on 1,000, barrels of oil a day.

Property transfers

Under present law, production from a proven oil or gas property (other than one on which secondary or tertiary recovery processes are used) which has been transferred after December 31, 1974, generally is not eligible for percentage depletion. However, this rule does not apply to testamentary transfers, certain changes in trust interests, or to situations in which the transferor and the transferee of the property must allocate one 1,000 barrel amount following the transfer. In other words, if the parties to the transfer must share a single 1,000 barrel amount for percentage depletion purposes, and only so long as they continue to be required to share that amount, such a transfer does not disqualify the production from the property. Because a single 1,000 barrel amount is not allocable between an individual and a controlled corporation, this special exception to the transfer rule does not apply. As a result, percentage depletion is not available with respect to production from a proven oil or gas property which has been transferred after 1974 by an individual to a controlled corporation.

Windfall profit tax

Under the windfall profit tax (H.R. 3919; Conference Report has passed the House), an individual (including certain related parties) and a controlled corporation are treated as one person for purposes of determining the number of barrels eligible for reduced rates. (For this purpose, "control" means 50 percent or more of the beneficial interest in the corporation.) Because of this treatment, generally there are few restrictions on property transfers. However, nonqualified transfers of shares in a controlled corporation result in production attributable to those shares being ineligible for reduced rates.

Issues

The following issues are raised by the bill.

The first issue is whether transfers of proven oil and gas properties to a corporation should be allowed without the loss of eligibility for percentage depletion if, but only to the extent that and for so long as, the transferor controls the transferee corporation, and is required to allocate a single 1,000 barrel amount with the corporation.

The next issue is whether an allocation of a single 1,000 barrel amount with a controlled corporation should be mandatory (as is the case in all percentage depletion exceptions to the transfer rule) or elective and, if elective, whether an election should be irrevocable and allowed only as to transferors, and when it should be made.

The third issue is whether an exception to the transfer rule should apply only to transfers by one person (but including all persons who are treated as one person for percentage depletion purposes) or should apply more broadly to any number of transferors who control the corporation following the transfer. If an exception is made applicable to transfers by more than one person, a subsidiary issue is whether the person or persons who transfer the oil and gas properties must control the corporation without regard to any other transferors.

The fourth issue is whether constructive ownership rules for purposes of determining control of the transferee corporation should be those applicable for percentage depletion purposes under present law or should include additional persons.

The next issue is whether any change in the transfer rule should apply retroactively, notwithstanding the statute of limitations, to transfers after 1974, so as to allow refunds, e.g., as to more than five years of oil and gas production, or whether any change should apply to post-1979 production from properties transferred after 1974.

The final issue is whether any change in the transfer rule should conform it to the similar rule applicable for windfall profit tax purposes.

Explanation of the bill

In general

The bill generally provides that percentage depletion would be available for oil and gas production subsequent to a transfer of a proven property to a controlled corporation if the transferor elects to allocate a single 1,000 barrel amount with the corporation. The election would apply only to transferors who own, and only so long as they continue to own, at least 80 percent of all the corporation's voting stock and at least 80 percent of all other corporate stocks. This determination would be made by taking into account stock owned by members of the transferor's family (including children, grandchildren, parents, and spouse) and trusts for their benefit.

If such an election is made, a single 1,000 barrel amount would have to be allocated between the transferor and the corporation in proportion to their respective production of domestic crude oil, taking into account any other allocation required by present law.

Election

The bill would require an election to be made by the earlier of: (1) the last day on which any electing transferor may file a claim for an income tax refund, including any extension, or (2) the last day on which the corporation may file such a claim, for the first taxable year for which an election is made. Thus, the bill generally would allow an election to be made within three years after the close of the taxable year following the transfer or, if earlier, after the date of enactment.

Anti-proliferation rules

The bill would grant the Secretary broad regulatory authority to prescribe regulations to ensure that the aggregate amount of oil and gas eligible for percentage depletion as to any shareholder or corporation is not greater than the amount which would have been allowed in the absence of the bill.

Effective date

The provisions of the bill generally would apply with respect to taxable years beginning after December 31, 1974. It also would allow claims for tax refunds with respect to oil and gas production between 1974 and the date of enactment.

Revenue effect

It is estimated that this provision will reduce budget receipts by $29 million in fiscal year 1981, $17 million in 1982, $19 million in 1983, $23 million in 1984, and by $26 million in fiscal year 1985. The figure for fiscal year 1981 reflects tax liabilities of prior years.

Prior Congressional consideration

Ways and Means Committee

Late in the second session of the 95th Congress, the Subcommittee on Miscellaneous Revenue Measures, of the Committee on Ways and Means, approved a bill (H.R. 13294) similar to H.R. 5124. H.R. 13294, as modified by the subcommittee, would have allowed a transfer, by a single transferor, of proven oil and gas properties to a single controlled corporation without the loss of percentage depletion. Under

H.R. 13294, the transferor and the controlled corporation would have been required to allocate a single 1,000 barrel amount, i.e., there was no election, and its provisions would have applied prospectively to production from properties transferred after the date of enactment. The 95th Congress adjourned before the full committee considered the bill.

Senate Finance Committee

On December 19, 1979, the Senate Finance Committee reported an amendment to H.R. 1212 (S. Rept. No. 96–532). Section 401 of that amendment is substantially similar to H.R. 5124, except that it applies only to post-1979 production from properties transferred after 1974. The Senate has not considered H.R. 1212.

5. H.R. 5716—Messrs. Fisher and Butler

Tax Treatment for Consolidated Return Purposes of Stock in Certain Transferor Railroads in the ConRail Reorganization

Present law

On April 1, 1976, a number of insolvent midwestern and eastern railroads, along with many of their subsidiaries and affiliates, transferred their railroad properties to the Consolidated Rail Corporation (ConRail). These transfers were mandated and approved by the Congress [1] in order to provide financially self-sustaining rail services in areas served by these bankrupt railroads.

Under the legislation which established it, ConRail, a taxable corporation, was to acquire, rehabilitate, and operate the railroad properties. The transferor railroads (and their subsidiaries and affiliates) received ConRail stock and certificates of value issued by the United States Railway Association, a nonprofit Government corporation formed to oversee the ConRail reorganization. Valuation of the transferred railroad properties, and the corresponding value of the certificates of value received by the transferor railroads, is to be determined ultimately by a special court created for this purpose.

In 1976, the Congress also enacted legislation to deal with certain of the tax consequences of this reorganization to ConRail, the transferor railroads, and the shareholders and creditors of the transferor railroads. Under this legislation,[2] the transfer of rail properties to ConRail was treated like reorganizations in general (and other bankrupt railroad reorganizations in particular) so that the transferor companies and their shareholders and security holders did not recognize gain or loss on the transfer and ConRail received a carryover basis in the properties it acquired (Code sec. 374(c)).

The 1976 tax legislation did not deal with certain other aspects of the ConRail reorganization such as investment credit recapture to the transferor railroads which arose from the mandated transfer of assets to ConRail. To deal with this aspect of the ConRail reorganization, the Revenue Act of 1978 (P.L. 95-600, approved November 6, 1978) added an exception to the investment credit recapture rules so that a transferor railroad will not be subject to recapture of the investment credit because of its transfer of railroad properties to ConRail.

Present law also provides rules which deal with the filing of con-

[1] The facilitating legislation for the transfers was the Regional Rail Reorganization Act of 1973 (P.L. 93-236, approved January 2, 1974) and the Railroad Revitalization and Regulatory Reform Act of 1976 (P.L. 94-210, approved February 5, 1976).

[2] P.L. 94-253, approved March 31, 1976.

solidated returns by affiliated groups of corporations.[3] Under the section 1502 consolidated return regulations, income tax liability generally is based on the combined income of the corporations in the affiliated group. Where one or more members of the affiliated group have incurred net operating losses, these losses offset taxable income of other members of the affiliated group, and the tax basis of their stock investment in the loss corporation is reduced generally by the allocated portion (based on stock ownership) of the losses reflected on the consolidated return. If the losses used on the consolidated returns exceed the basis of the stock owned by other members of the group, the result is the creation of excess loss accounts which are the equivalent of negative basis in the stock of the loss corporation owned by the other members.

Where there is a disposition of the loss affiliate's stock or the stock ownership requirements are not met, any excess loss accounts in existence at that time are "restored" by treating them as income.[4] The term disposition is broadly defined and includes the occurrence of worthlessness or insolvency of the loss affiliate. In these situations, ordinary income will generally be recognized through triggering the excess loss account and special rules are provided for determining insolvency in situations concerning excess loss accounts. Where an excess loss account is restored, there is no provision in present law for revival of the previously used net operating loss by the loss affiliate.

Issue

The issue is whether a rule should be provided concerning the application of the consolidated return regulations to an affiliated group which included a transferor railroad in the ConRail reorganization.

Explanation of the bill

The bill would provide a statutory rule, for purposes of applying the consolidated return regulations, under which the determination of worthlessness of the capital stock of a transferor railroad in the ConRail reorganization is postponed until a determination of value by the special court becomes final.

The only known beneficiary of this bill is DERECO, Inc., a member of an affiliated group of corporations with the Norfolk and Western Railway Company, Inc., the parent corporation in this group. DERECO, Inc. is a wholly owned subsidiary of Norfolk and Western Railway Company, Inc. and is the sole stockholder of the Erie Lackawanna Railway Company, one of the transferor railroads in the ConRail reorganization. During a period of years Erie Lackawanna Railway Company, as a member of the Norfolk and Western affiliated group, was included in consolidated income tax returns filed by the

[3] These rules are primarily set forth in regulations promulgated under specific statutory authority (Code sec. 1502). An affiliated group of corporations is generally defined as a group of corporations connected with a common parent corporation through ownership of at least 80 percent of the voting power of all classes of voting stock and at least 80 percent of each class of nonvoting stock. However, certain corporations are generally not included in an affiliated group (Code sec. 1504).

[4] These rules are necessary in order to reflect the reduction in tax liability the other members of the affiliated group have derived through use of the losses.

group. Erie Lackawanna Railway Company reported substantial net operating losses which were used in the consolidated returns to offset taxable income reported by other members of the Norfolk and Western group. These losses reduced the basis of the Erie Lackawanna stock owned by DERECO, Inc. to zero and resulted in the creation of an excess loss account.

During 1972, Erie Lackawanna Railway Company entered into bankruptcy proceedings and eventually became one of the railroads which transferred rail properties to ConRail on April 1, 1976. The Internal Revenue Service has taken the position that the excess loss account of DERECO, Inc. will be restored to income for the 1976 consolidated return year of the Norfolk and Western affiliated group of corporations.[5]

Effective date

The provisions of the bill would apply to taxable years ending after March 31, 1976.

Revenue effect

The revenue effects of the bill are indeterminate with respect to both the amount of tax involved and the timing of tax payment. If the excess loss account were restored to income for the 1976 tax year, the taxpayer would incur an additional tax liability of about $15 million. However, the amount of estimated tax liability, if any, may be adjusted after the determination of value by the special court. Because the taxpayer is expected to oppose assertion of a deficiency for its 1976 tax year, there would be an effect on budget receipts only if the taxpayer's position were not sustained and this occurred before the determination of the value by the special court became final.

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[5] The trustees in bankruptcy of the Erie Lackawanna Railway Company have proposed that the previously used net operating losses of Erie Lackawanna be revived to the extent the excess loss account is restored to income of the Norfolk and Western affiliated group.

6. H.R. 5968—Mr. Duncan

Life Benefits of Voluntary Employees' Beneficiary Associations

Present law

Voluntary employees' beneficiary associations which provide for the payment of life, sickness, accident, or other benefits to their members or to the dependents or designated beneficiaries of their members are entitled to tax-exempt status under Code section 501(c)(9), provided no part of such associations' net earnings inures (except for benefit payments) to the benefit of any individual.

Proposed Treasury regulations would define the term "life benefits" to include life insurance benefits, or similar benefits payable on the death of the member, made available to members for current protection only. Under the proposed regulations, term life insurance would be an allowable benefit, but life insurance protection under an endowment insurance plan or a plan providing cash surrender values to the member would not be allowed. The proposed regulations would permit payment of life benefits to any designated beneficiary of a member.[1]

Issue

The issue is whether the "life benefits" which a tax-exempt voluntary employees' association may provide should be limited to those benefits which are payable on a member's death and available for current protection only, such as term life insurance, or whether a broader range of benefits, such as those involving cash surrender values, should be allowed.

Explanation of the bill

The bill would allow tax-exempt voluntary employees' beneficiary associations to provide life benefits through whole or term life insurance policies or otherwise.

The potential beneficiaries of this bill would be all voluntary employees' beneficiary associations. One known beneficiary would be the Army Mutual Aid Association.

Effective date

The bill does not specify an effective date.

Revenue effect

An estimate of the revenue effect of this bill is not yet available.

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[1] Proposed Treas. Reg. sec. 1.501(c)(9)—1(b)(3)(iii).

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