[JOINT COMMITTEE PRINT]

DESCRIPTION OF TAX BILLS

(S. 805, S. 1214, S. 1304, S. 1320, AND S. 1369)

SCHEDULED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

OF THE

COMMITTEE ON FINANCE

ON JULY 24, 1981

PREPARED FOR THE USE OF THE

COMMITTEE ON FINANCE

BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

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INTRODUCTION

The bills described in this pamphlet have been scheduled for a public hearing on July 24, 1981, by the Senate Subcommittee on Taxation and Debt Management.

There are six bills scheduled for the hearing: S. 805 (relating to dividends received by life insurance companies), S. 1214 (relating to repeal of the limitation on the deduction of investment interest), S. 1304 (relating to the tax treatment of business development companies), S. 1320 (relating to imposing the excise tax on trucks at the retail level), S. 1369 (relating to elimination of withholding on certain gambling winnings), and S. 531 (relating to an income tax credit for planting of certain pecan trees).

The first part of the pamphlet is a summary of the bills. This is followed by a more detailed description of the bills, including present law, issues, an explanation of the provisions of the bills, and effective dates. The estimated revenue effects are not yet available.

I. SUMMARY

1. S. 806—Senators Durenberger and Mitchell

Dividends Received by Life Insurance Companies

Under present law, certain dividends from subsidiary members of an affiliated group of corporations may be fully deducted from income by the member corporation receiving the dividend. Otherwise, 85 percent of dividends received by one corporation from another may be deducted (Code sec. 243). Life insurance companies are taxed on that portion of the company's investment income not allocated to policyholders. Dividends constitute investment income subject to this allocation and the company is entitled to a dividend received deduction with respect to that portion of dividends included in taxable investment income (Code secs. 804 and 809).

Under the bill, dividends from a subsidiary corporation received by a life insurance company that are eligible for the 100-percent dividend received deduction would not be subject to the allocation applied to other investment income and would be fully deductible. The amendment would apply to dividends received after December 31, 1980.

2. S. 1214—Senator Boschwitz

Repeal of Limitation on Interest on Investment Indebtedness

Under present law, interest paid or incurred with respect to property held for investment generally may be deducted only to the extent of net investment income plus $10,000 of other income. Net investment income in general consists of income from interest, dividends, rents, royalties, and short-term capital gain from the disposition of investment property, less expenses connected with the production of investment income (Code sec. 163(d)).

The bill would repeal the limitation on the deductibility of investment interest, effective for taxable years beginning after December 31, 1980.

3. S. 1304—Senators Chafee, Durenberger, Sarbanes, and Baucus

Tax Treatment of Business Development Companies

Under present law, regulated investment companies are permitted to deduct dividends paid to their shareholders if they satisfy certain statutory requirements. In general, to qualify as a regulated investment company, a corporation must register under the Investment Company Act, derive its income from dividends, interest and the sale of stocks and securities, and meet certain investment diversification requirements.

In order to register under the Investment Company Act, a corporation must have more than 100 shareholders or must be making or presently proposing to make a public offering.

Under the Small Business Incentive Act of 1980 (P.L. 96–477), certain investment companies providing capital and managerial assistance to small businesses may elect to be treated as "business development companies" in lieu of registering under the Investment Company Act.

The bill would permit these "business development companies" to qualify for the conduit tax treatment applicable to regulated investment companies. In addition, the bill would permit certain small business investment companies with fewer than 100 shareholders and not proposing to make a public offering to qualify for such treatment. The bill would be applicable to taxable years beginning on or after October 21, 1980.

4. S. 1320—Senator Heinz

Modification of Excise Tax on Trucks and Truck Parts

Under present law, manufacturers excise taxes are imposed at a 10-percent rate on heavy-duty trucks, highway tractors and their related trailers and semitrailers and at an 8-percent rate on truck parts and accessories (Code sec. 4061). A manufacturers excise tax is imposed on tires and tubes (Code sec. 4071).

The bill would impose the excise taxes on heavy-duty trucks, etc., and on truck parts and accessories at the retail level. In addition, the bill would provide for regulations to exclude from the excise tax on tires and tubes articles that are sold for use on trucks, highway tractors and their related trailers and semitrailers. The amendment would apply to sales on and after the first day of the first taxable quarter commencing more than 30 days after enactment.

5. S. 1369—Senator Huddleston

Elimination of Income Tax Withholding on Certain Gambling Winnings

Under present law, proceeds from certain wagers are subject to withholding at a 20-percent rate. Withholding is not imposed with respect to winnings from slot machines, keno, or bingo, and winnings subject to withholding generally must exceed $1,000 and be 300 times the amount wagered (Code sec. 3402(q)).

The bill would repeal the provision for withholding on gambling winnings. It would apply to amounts won after the date of enactment.

6. S. 531—Senator Heflin

Tax Credit for Planting of Certain Pecan Trees

Present law allows taxpayers to take deductions for uninsured business losses and for certain uninsured casualty losses. In general, this deduction cannot exceed the adjusted basis of the property destroyed.

In addition, capital costs incurred in bringing fruit-bearing trees to the income-producing stage have been held to qualify for the investment tax credit.

The bill would provide a $10-per-tree tax credit for planting pecan trees to replace pecan trees that were destroyed, in September 1979, by Hurrican Frederick. The credit would be available for planting expenses incurred after August 31, 1979.

II. DESCRIPTION OF BILLS

1. S. 805—Senators Durenberger and Mitchell

Dividends Received by Life Insurance Companies

Present law

Intercorporate dividends

Under present law, a dividend received by a corporation is generally includible in gross income, but the recipient corporation generally is allowed a deduction for 85 percent of the dividend. If a corporation which is a member of an affiliated group of corporations [1] receives a dividend from another member of the group, the deduction allowed the recipient generally is increased to 100 percent. A member corporation in an affiliated group is eligible for the 100-percent deduction for dividends received only if the affiliated group so elects and certain other requirements are met.

Investment income received by life insurance companies

Present law relating to life insurance companies applies to both a "stock" company (*i.e.*, a corporation owned by its shareholders) and to a mutual life insurance company (i.e., a company is owned by its policyholders). A life insurance company, whether a stock company or a mutual company, is generally taxed on its income at the regular corporate rates. Because of the nature of life insurance, special rules apply in computing life insurance company taxable income.

A life insurance company's taxable income does not include that percentage of the company's investment yield deemed to be set aside to meet policy and other contract liability requirements for policyholders (the policyholders' share of investment yield). The percentage of the total investment yield which is deemed to be set aside to meet policy and other contract liability requirements is applied to each and every item of investment yield, including a dividend. The remainder of the item of investment yield is the company's shares of the item, and is taken into account in determining life insurance company taxable income.

In the case of a dividend, the 85-percent or 100-percent deduction for dividends received is allowed only for the company's share of the dividend. The remainder of the dividend is excluded from life insurance company taxable income as the policyholders' share of the dividend.

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[1] In general, an affiliated group of corporations includes all corporations connected through stock ownership with a common parent corporation if at least 80 percent of the voting stock of each corporation (other than the parent corporation) is owned by other corporations in the group. For certain of the income tax rules, including the determination of the tax rates applied to the taxable income of each member corporation, an affiliated group of corporations is treated as a single taxpayer.

Dividends paid by insurance companies

Under present law, a dividend paid by a corporation (including a stock life insurance company) to a shareholder generally is not allowed as a deduction to the corporation and is includible in the gross income of the shareholder, subject to the partial dividends-received exclusion for individuals [2] and the dividends-received deduction for corporations. However, a dividend paid by a life insurance company (whether a stock company or a mutual company) to a policy holder generally is allowed as a deduction, within limits,[3] to the company.

Issue

The issue is whether dividends received by a life insurance company from an affiliated corporation should be allocated solely to the company's share of investment yield and deducted in full, so that other income will be allocated to the excludable policyholders' share of investment yield.

Explanation of the bill

The bill provides that if a life insurance company is entitled to the 100–percent deduction for dividends received, dividends received from affiliated corporations will be allocated solely to the company's share of investment yield. Under present law, the life insurance company would be allowed to deduct the full amount of the dividend in computing taxable income.

Under the bill it is intended that the allocation of such dividends only to the company's share of investment yield generally would have the effect of requiring an offsetting reallocation of other investment yield from the company's share to the policyholders' share of investment yield. Under present law, the investment yield so reallocated to meet policyholder requirements would be excluded from life insurance company taxable income.

Effective date

The bill would be effective for qualifying dividends received from affiliated corporations in taxable years beginning after December 31, 1980.

Revenue effect

The estimate of the revenue effect of the bill is not yet available.

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[2] For 1981 and 1982, individuals may exclude from gross income up to $200 ($400 for a joint return) of dividends and interest income received from domestic sources. After 1982, the exclusion reverts to prior law, under which the exclusion applies only to dividends and is limited to $100 ($200 for a joint return).

[3] The deduction for dividends to policyholders is generally allowed against the excess of the company's gain from operations over its taxable investment income, plus $250,000. Taxable investment income is the company's share of investment yield with certain adjustments.

2. S. 1214—Senator Boschwitz

Repeal of Limitation on Interest on Investment Indebtedness

Present law

In the case of individuals, interest paid or accrued on indebtedness incurred with respect to property held for investment may be deducted only to the extent of the taxpayer's net investment income and certain expenses exceeding rental income from a net lease plus $10,000 of other income ($5,000 in the case of a separate return by a married individual). For this purpose, investment income includes dividends, interest, rents, royalties, and net short-term gain attributable to the disposition of investment property. However, it includes no amount derived from conducting a trade or business. For example, salary income from a closely held corporation is not investment income. Before applying the limitation, investment income must first be reduced by expenses (other than interest) directly connected with its production. Disallowed investment interest is carried forward to succeeding taxable years subject to the limitation on deduction in the carryforward year (Code sec. 163(d)).

The limitation on deducting investment interest was originally enacted in the Tax Reform Act of 1969 in order to prevent mismatching of income and deductions and possible conversion of ordinary income into capital gain. For example, an individual could borrow a substantial amount to purchase stock which returned small current dividends but with potential capital appreciation. Income from the investment was deferred and could later be realized as capital gain when the stock was disposed of. Meanwhile, interest on the indebtedness could be deducted currently to offset salary or other income of the taxpayer.

Issue

The issue is whether the limitation on the deductibility of investment interest should be repealed.

Explanation of the bill

The bill would repeal the limitation on the deduction of investment interest.

Effective date

The repeal would apply to taxable years beginning after December 31, 1980.

Revenue effect

The estimate of the revenue effect of the bill is not yet available.

3. S. 1304—Senators Chafee, Durenberger, Sarbanes, and Baucus

Tax Treatment of Business Development Companies

Present law

A regulated investment company is permitted a deduction for capital gain dividends and ordinary income dividends paid to its shareholders if it meets several tests. Among other requirements, a regulated investment company must be a domestic corporation other than a personal holding company. Moreover, it either must be registered with the Securities and Exchange Commission at all times during the taxable year as a management company or unit investment trust under the Investment Company Act of 1940, or it must be a common trust fund or similar fund which is not included in the term "common trust fund" under the Internal Revenue Code and which is excluded by the Investment Company Act from the definition of investment company (Code sec. 851(a)). In order to register under the Investment Company Act of 1940, a corporation must have at least 100 stockholders or must be making or presently proposing to make a public offering.

Under the Small Business Incentive Act of 1980 (P.L. 96-477), certain investment companies providing capital and managerial assistance to small business may elect to be treated as "business development companies" in lieu of registering under the Investment Company Act.

A small business investment company operating under the Small Business Investment Act of 1958 is eligible to be treated as a regulated investment company if it meets the applicable requirements, including the requirement of registering under the Investment Company Act. Thus, it may qualify as a regulated investment company only if it has more than 100 shareholders or is making or presently proposing to make a public offering.

Issue

The issue is whether the provisions applicable to regulated investment companies should be extended to business development companies without having to meet the requirements of registration, as well as to small business investment companies with fewer than 100 shareholders and not proposing to make a public offering.

Explanation of the bill

Under the bill, a "business development company" (as defined in the bill) would not be prevented from qualifying as a regulated investment company by the fact that the company did not register under the Investment Company Act. The bill defines a "business development company" as a domestic corporation other than a personal holding company that is (i) a "business development company" under the Investment Company Act as amended by the Small Business

Incentive Act of 1980 or (ii) a small business investment company licensed before July 1, 1980 under the Small Business Investment Act of 1958 or licensed on an application filed within one month of its incorporation.

The bill would have two main effects. First, it would enable a company electing to be treated as a "business development company" under the Investment Company Act to qualify as a regulated investment company notwithstanding the fact that it does not register under the Investment Company Act.

Second, it would allow certain small business investment companies to qualify as regulated investment companies notwithstanding that such companies did not register under the Investment Company Act and did not have at least 100 shareholders and were not making or presently proposing to make a public offering.

Effective date

The bill would be effective for taxable years beginning on or after October 21, 1980.

Revenue effect

The estimate of the revenue effect of the bill is not yet available.

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[1] Generally, a closed-end company which has elected to be regulated under the Small Business Investment Incentive Act of 1980.

4. S. 1320—Senator Heinz

Modification of Excise Taxes on Trucks and Truck Parts

Present law

Under present law, an excise tax is imposed on heavy-duty trucks, highway tractors and their related trailers and semitrailers sold by the manufacturer or importer (including parts or accessories sold thereon) (Code sec. 4061(a)(1).[1] The tax is 10 percent (5 percent after September 30, 1984) of the manufacturer's or importer's selling price.

Present law imposes an excise tax on parts and accessories (other than tires and inner tubes) sold by the manufacturer or importer for trucks, highway tractors and their related trailers and semitrailers (Code sec. 4061(b)).[2] The tax is 8 percent (5 percent after September 30, 1984) of the maufacturer's or importer's selling price.

Present law also imposes an excise tax on tires and inner tubes sold by the manufacturer or importer. The amount of tax is 9.75 cents a pound for highway tires (4.875 cents a pound after September 30, 1984), 1 cent a pound for laminated nonhighway tires, 4.875 cents a pound for other nonhighway tires, 5 cents a pound for tread rubber (no tax after September 30, 1984), and 10 cents a pound for inner tubes (9 cents a pound after September 30, 1984) (Code sec. 4071).

The revenues from the excise taxes on trucks, truck parts, and tires, tubes, and tread rubber go into the Highway Trust Fund (through September 30, 1984, under present law).

Issues

The main issues presented by the bill are whether the excise taxes on trucks and truck parts should be changed from a manufacturers excise tax to a retailers excise tax and the related tax administrative and collection issues involved in such a change. Another issue is how, in view of the bill's proposed repeal of any excise tax on tires and tubes, the excise taxes on tires and tubes on trucks should apply.

Explanation of the bill

Tax on trucks and truck parts

Under the bill, the present manufacturers excise tax on heavy-duty trucks, highway tractors and their related trailers and semitrailers would be replaced by a retailers excise tax on those articles. Thus, the tax would be collected when an article is first sold at retail rather than

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[1] Trucks having a gross vehicle weight of 10,000 pounds or less are exempt from the tax, as are truck trailers, and semitrailers of such weight (Code sec. 4061(a)(2)).

[2] Parts and accessories are exempted if sold for resale by the purchaser on or in connection with the first retail sale of a light-duty truck (Code sec. 4063(e)).

when sold by the manufacturer. The amount of tax would be 10 percent of 90 percent of the actual retail selling price of an article. Actual retail selling price is defined to include any charge for coverings, containers and packing, and to exclude the amount of this tax, the amount of any State or local retail sales tax (if stated separately), and appropriate charges for transportation, delivery, insurance or installation.

Under the bill, the present manufacturers excise tax on truck parts and accessories would be replaced by a retailers excise tax on those articles. The amount of tax would be 8 percent of 75 percent of the actual retail selling price (determined as in the preceding paragraph) of an article.

The bill would not change the reductions in tax rates which are scheduled for these excise taxes under present law. On and after October 1, 1984, the retailers excise tax on heavy-duty trucks, etc., would be 5 percent of 90 percent of the actual retail selling price, and the retailers excise tax on truck parts and accessories would be 5 percent of 75 percent of the actual retail selling price.

Tax on tires and tubes on trucks

The bill provides for regulations under which the manufacturers excise tax on tires and inner tubes would not apply to any tire or inner tube which is sold for use by the purchaser (or any subsequent purchaser) on a truck, highway tractor or a related trailer or semitrailer.

Effective date

The retailer excise taxes provided by the bill would replace the present manufacturers excise taxes on heavy-duty trucks, etc, and on truck parts and accessories beginning on the first day of the first taxable quarter which commences more than 30 days after the date of enactment.

Exemption of certain tires and inner tubes from the manufacturers excise tax on tires and inner tubes would also take effect on the first day of the first taxable quarter which commences more than 30 days after the date of enactment.

Revenue effect

The estimate of the revenue effect of the bill is not yet available.

5. S. 1369—Mr. Huddleston

Elimination of Income Tax Withholding on Certain Gambling Winnings

Present law

In certain circumstances, proceeds from wagers are subject to income tax withholding at a rate of 20 percent (Code sec. 3402(q)). The general rule is that gambling winnings are subject to withholding if the proceeds exceed $1,000 and are at least 300 times as large as the amount wagered. However, special rules apply to winnings from certain types of wagers.

Proceeds of more than $5,000 from wagers placed with State-conducted lotteries are subject to withholding. In addition, proceeds of more than $1,000 from (1) a wager placed in a sweepstakes, wagering pool, or non-State-conducted lottery, or (2) a wagering transaction in a pari-mutuel pool with respect to horse races, dog races, or jai alai, if the amount of such proceeds is at least 300 times as large as the amount wagered, are subject to withholding.

Withholding is not imposed in the case of winnings from a slot machine, keno, or bingo.

Every person who is to receive a payment of gambling winnings subject to withholding is required to furnish the payor with a statement containing his name, address, and taxpayer identification number. The payor of gambling winnings is required to file Form W–2G (reporting of payment of gambling winnings) with the Internal Revenue Service.

Background

The Tax Reform Act of 1976 required the IRS to report to the House Committee on Ways and Means and the Senate Committee on Finance on the operation of the present reporting system as applied to winnings from keno, bingo, and slot machines, and to make a recommendation whether or not such winnings should be subject to withholding. In a report issued in December 1980 ("Compliance in Reporting Gambling Winnings"), the IRS recommended, among other things, that the existing withholding floors be lowered to $600; that withholding be required on winnings of $1,500 or more from keno: and that withholding be required on winnings of $1,200 or more from bingo and slot machines.

Issue

The issue is whether withholding on gambling winnings should be eliminated.

Explanation of the bill

The bill would repeal the provisions for withholding on gambling winnings.

Effective date

The bill would apply to payments of gambling winnings made after the date of enactment.

Revenue effect

The estimate of the revenue effect of the bill is not yet available.

6. S. 531—Senator Heflin

Tax Credit for Planting of Certain Pecan Trees

Present law

Under present law, a corporation may deduct the amount of property losses sustained during the taxable year which are not insured or otherwise recoverable (sec. 165). An individual may deduct the amount of an unrecoverable loss incurred in a trade or business, in a transaction entered into for profit, or (subject to a $100 floor per occurrence) as a casualty or theft loss (sec. 165(c)).

In the case of partial loss caused by casualty, the amount of the loss equals the difference between the value of the property immediately preceding the casualty and its value immediately thereafter (Treas. Reg. § 1.165–7(b)). However, the deduction cannot exceed the property's adjusted basis (sec. 165(b)). If business or income-producing property is completely destroyed, the amount deductible is the adjusted basis of the property (Treas. Reg. § 1.165–7(b)).

The Internal Revenue Service has held that the costs of trees and other capital costs incurred in their development become eligible for the investment tax credit when they have reached the income-producing stage.[1]

Issue

The issue is whether taxpayers whose pecan trees were destroyed by Hurricane Frederick, in September 1979, should be given a tax credit for replacing those trees.

Explanation of the bill

The bill would provide taxpayers with a nonrefundable tax credit for expenses involved in the planting of pecan trees for the purpose of replacing pecan trees destroyed in September 1979 by Hurricane Frederick. The amount of the credit would be $10 per pecan tree. Excess credits could be carried forward to succeeding taxable years.

Effective date

The credit generally would be available to taxpayers in taxable years beginning after December 31, 1980, and before January 1, 1986. However, in the case of a taxpayer's first taxable year beginning after December 31, 1980, the credit would be available for expenses incurred after August 31, 1979.

Revenue effect

The estimate of the revenue effect of the bill is not yet available.

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[1] Rev. Rul. 65–104, 1965–1 CB28, as clarified by Rev. Rul. 66–183, 1966–2 CB47.

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