[JOINT COMMITTEE PRINT]

DESCRIPTION OF MISCELLANEOUS TAX BILLS

SCHEDULED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON SELECT REVENUE MEASURES

OF THE

COMMITTEE ON WAYS AND MEANS

ON SEPTEMBER 27, 1979

PREPARED FOR THE USE OF THE

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BY THE STAFF OF THE

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INTRODUCTION

The bills described in this pamphlet are five of those on which the Subcommittee on Select Revenue Measures of the Committee on Ways and Means has announced a public hearing for September 27, 1979. (A description of another bill, H.R. 5043, also scheduled for the September 27 hearing, is described in a separate pamphlet.)

In connection with this hearing, the staff of the Joint Committee on Taxation has prepared a description of the bills.

The first part of the pamphlet summarizes the bills in consecutive bill number order. This is followed in the second part by a more detailed description of each bill, indicating in each case the present law treatment, the issue involved, an explanation of what the bill would do, the effective date of the provision, and the revenue effect of the provision.

I. SUMMARY OF BILLS

1. H.R. 2993—Messrs. Beard (R.I.) and St Germain

Tax Treatment Under Rhode Island Indian Claims Settlement Act

The bill would provide that the lands received by the public corporation established pursuant to the Rhode Island Indian Claims Settlement Act would generally be exempt from Federal, State, or local taxation, except for taxes on income-producing activities. The bill would not prevent the imposition of charges in lieu of taxes for services provided in connection with settlement lands. The bill would also provide that private owners selling land to be conveyed to the corporation pursuant to the settlement could treat the sales as involuntary conversions, thus allowing deferral of tax on the gain if sale proceeds are reinvested.

2. H.R. 3244—Mr. Fowler

Qualification of Leased Furniture for the Investment Tax Credit

Under present law, property used predominately to furnish certain lodging does not qualify for the investment tax credit. Generally, this rule applies to property used for nontransient residential purposes since qualified investment for property used by a hotel or motel is eligible for the investment tax credit. Under the bill, furniture acquired by a person who is engaged in the trade or business of renting or leasing furniture to others would qualify for the investment tax credit, irrespective of the use made of such property by the lessee.

3. H.R. 3586—Messrs. Rostenkowski, Holland, Campbell, Sabo, Ireland, Watkins, Luken, Lederer, Lehman, Schulze, Downey, Duncan (Tenn.), and Jones (Okla.)

Definition of Youth Participating in a Qualified Cooperative Education Program for Purposes of the Targeted Jobs Credit

Under present law, the targeted jobs credit may be claimed for the hiring of youths who actively participate in qualified cooperative education programs, who have attained the age of 16 but who have not attained the age of 19, and who have not graduated from high school or vocational school. The bill would extend the availability of the targeted jobs credit to the hiring of such youths who have not attained the age of 20.

4. H.R. 4298—Mr. Rostenkowski

Special Rule for Certain Distributions from Money Purchase Pension Plans

Under present law, if an employer maintains a tax-qualified defined benefit pension plan and a tax-qualified money purchase pension plan, and if an employee is covered by both plans, a total distribution of the balance of the employee's interest in the money purchase plan to the employee (or the employee's spouse on account of the employee's death) is not eligible to be rolled over tax-free to an individual retirement account or to another qualified plan unless a total distribution is also made from the defined benefit plan in the same taxable year. The bill would allow an employee (or the employee's spouse) to make a tax-free rollover of a total distribution from a qualified money purchase plan where the employee is also covered by a qualified defined benefit plan maintained by the same employer even though a total distribution is not made from the defined benefit plan in the same taxable year.

5. H.R. 4446—Messrs. Holland, Conable, Duncan (Tenn.), Vander Jagt, Gradison, Jenkins, Ford (Tenn.), Bafalis, and Fowler

Method of Accounting for Railroad Track Assets

Under present law, the Internal Revenue Service allows the railroad industry to use the retirement-replacement-betterment (RRB) method of accounting for railroad track assets, which is the same method required for these assets by the Interstate Commerce Commission. Under the RRB method, when a new railroad line is laid, the costs (for rail, ties, ballast, fasteners, and labor) are capitalized, and these costs are not depreciated, but when replacements are made to an existing line, the replacement costs are deducted currently.

The RRB method is not codified as part of the Internal Revenue Code, but is recognized as an acceptable method in court decisions and Internal Revenue Service rulings. The bill would codify the RRB method, effective for taxable years ending after December 31, 1953.

II. DESCRIPTION OF BILLS

1. H.R. 2993—Messrs. Beard (R.I.) and St Germain

Tax Treatment Under Rhode Island Indian Claims Settlement Act

Present law

In 1975, the Narragansett Indian Tribe brought suit against the State of Rhode Island and private landowners based on the Tribe's claims to certain land in Charlestown, Rhode Island. The Tribe argued that these lands had been alienated by it in 1880 in violation of the Trade and Intercourse Act of 1790. The Interior Department has held that the Tribe's claim is "credible." Prior to trial, the parties to the suit entered into a settlement agreement which required both State and Federal legislation for its implementation. Pursuant to the settlement, the Tribe's land claims have been extinguished. A public corporation (which is not a part of the State government) has been created under Rhode Island law with 5 directors to be appointed by the Tribe and 4 by State and local officials (the "Corporation"). The Corporation is to receive 1,060 acres of land now belonging to the State. Also pursuant to the settlement, a fund of $3.5 million has been established in the U.S. Treasury for the purpose of purchasing 900 acres of privately held land in Charlestown at fair market value from its owners. Options have already been secured on 550 acres of this land. The land, when acquired by the Secretary of the Interior with the proceeds of the fund, is to be conveyed to the Corporation.

All land owned by the Corporation is to be held in trust for the benefit of the Tribe. All of the land contributed by the State, and at least 75 percent of the land acquired from private owners, is to be permanently dedicated to conservation purposes. It is anticipated that the Tribe may use the remaining land in other ways which reflect its heritage, or to provide housing for poor or aged members of the Tribe.

The settlement agreement further provided "That the parties to the Lawsuits will support efforts to obtain deferral of both State and Federal income taxes resulting from the conveyance of privately held portions of the Settlement Lands."

The Federal Government's participation in the settlement is under the authority of the Rhode Island Indian Claims Settlement Act, passed in 1978. That law provided for the extinguishment of aboriginal Indian title, creation of the fund for the purchase of the privately held land, and transfer of that land to the corporation to be formed under the settlement agreement. It did not deal with any of the tax consequences of the settlement.[1]

It is unclear whether, as the facts and circumstances develop, the Corporation could qualify for general exemption from Federal income tax (Code sec. 501). Also, the Corporation's receipt of land in settlement of the Tribe's damage claim might not be subject to income taxation.

Recognition of gain on the sale of property which is involuntarily converted (e.g., sold under the threat or imminence of condemnation) may generally be deferred if the taxpayer, for the purpose of replacing the property, purchases property similar or related in service or use to the converted property. Recognition of gain is limited to the amount by which the amount realized from the conversion exceeds the cost of the replacement property. (Code sec. 1033.) Generally, the replacement must occur within 2 years after the first year in which gain is realized. However, in the case of certain real property held for productive use in a trade or business or for investment, up to 3 years for replacement may be permitted.

Issues

The issues presented by the bill are:

(1) the extent to which the settlement land received by the Corporation should be exempt from tax;

(2) whether the private landowners who sell land pursuant to the settlement should be permitted to defer recognition of gain; and

(3) to what extent this bill should serve as precedent for the tax treatment of settlements of other similar suits brought by Indian tribes in other states.

Explanation of the bill

The bill generally would provide that the settlement land and any moneys received by the Corporation from the Treasury fund shall not be subject to any form of Federal, State, or local taxation. Thus, for example, the Corporation would not realize income on receipt of the land and the land would be exempt from local property taxes. (An exemption from local property taxes is also provided in the Rhode Island legislation creating the Corporation.) However, the general exemption rule would not apply to any income-producing activities occurring on the settlement lands, and nothing in the bill would prevent the imposition of payments in lieu of taxes on the Corporation for services provided in connection with the settlement lands. The bill would not affect the question of whether the Corporation generally qualifies for exemption from Federal income taxation.

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[1] As introduced, the bill (H.R. 12860, 95th Congress) contained tax provisions identical to the provisions of H.R. 2993. It is understood that these tax provisions were eliminated from H.R. 12860 to expedite passage in the brief time which remained in the 95th Congress after consideration of the legislation in 1978.

While the Federal Government was not directly involved in drafting the settlement agreement itself, the Administration (through the White House, the Office of Management and Budget, and the Interior Department), the staffs of the House Interior and Insular Affairs Committee, the Senate Indian Affairs Committee, and the staffs of the Rhode Island Congressional delegation took part, along with the parties to the settlement agreement, in drafting the 1978 Settlement Act. Thus, these participants supported, with certain exceptions, the entire agreement of the parties, including the tax provisions.

The bill contains detailed rules as to the circumstances under which amounts received by the Corporation from the Treasury fund would be exempt from tax. However, under the mechanism actually adopted to implement the settlement, the Secretary of the Interior will use the fund to acquire land and will transfer the land to the Corporation, rather than transferring amounts from the fund to the Corporation to enable the Corporation to purchase the land directly. Accordingly, the committee may wish to delete these provisions since they appear to be unnecessary.

The bill also would provide that, for Federal income tax purposes, any sale or disposition of private settlement lands pursuant to the terms and conditions of the settlement agreement is to be treated as an involuntary conversion. This would permit the sellers to defer gain on the sale to the extent allowed by section 1033.

Effective date

The provisions of the bill would be effective upon enactment.

Revenue effect

It is estimated that this bill would reduce budget receipts by a negligible amount annually for fiscal years 1980 through 1983.

2. H.R. 3244—Mr. Fowler

Qualification of Leased Furniture for the Investment Tax Credit

Present law

Under present law, certain depreciable property used by a taxpayer in the taxpayer's trade or business and placed in service during the tax year is eligible for the investment credit (Code secs. 38, 48).

Specifically excluded from eligibility for the credit is property used predominately to furnish lodging or in connection with the furnishing of lodging unless the property consists of coin-operated machines (vending machines, washing machines, dryers), or property used by a hotel or motel, or a non-lodging commercial facility open to the general public which is located in a lodging facility (Code sec. 48) (a) (3)). Thus, for example, most of the property used in an apartment house or dormitory, including lobby furniture and office equipment, will not qualify for the credit.[1]

Recently, a district court held that a taxpayer in the business of leasing furniture to apartment building owners and to tenants of apartment buildings was denied the credit for furniture leased to the apartment building owners because the property was used in connection with the furnishing of lodging, but permitted the credit for furniture leased directly to tenants.[2] The Internal Revenue Service has announced that it will not follow this decision with respect to the qualification of furniture leased to tenants.[3]

Issue

The issue is whether furniture purchased by a person who is engaged in the business of furniture rental or leasing to others should be qualified for the investment credit, irrespective of whether the lessee of such furniture uses it in connection with the furnishing of lodging or for any other use.

Explanation of the bill

Under the bill, furniture purchased by a person who is engaged in the trade or business of furniture rental or leasing to others would qualify for the investment tax credit, irrespective of how the lessee uses the property.

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[1] Treas. Regs. § 1.48–1(h) (1) (ii).

[2] *Aaron Rents, Inc.* v. *United States*, 78–2 USTC ¶ 9727, 42 AFTR 2d 78–5940 (N.D. Ga. 1978).

[3] Rev. Rul. 78–438, 1978–52 I.R.B. 7.

Effective date

The provisions of the bill would apply for all taxable years ending on or after August 15, 1971 (the general effective date for the reinstatement of the investment tax credit by the Revenue Act of 1971). However, no provision is made by the bill to open taxable years with respect to which credits or refunds are barred by the statute of limitations under section 6511.

Revenue effect

It is estimated that this bill would reduce budget receipts by $5 million in 1980, $2 million annually in 1981 and 1982, $3 million in 1983, and $4 million in 1984.

3. H.R. 3586—Messrs. Rostenkowski, Holland, Campbell, Sabo, Ireland, Watkins, Luken, Lederer, Lehman, Schulze, Downey, Duncan (Tenn.), and Jones (Okla.)

Definition of Youth Participating in a Qualified Cooperative Education Program for Purposes of the Targeted Jobs Credit

Present law

Under present law, a credit is provided for the hiring of members of certain target groups. The credit, which is elective, is equal to 50 percent of qualified first-year wages and 25 percent of qualified second-year wages. One of the target groups consists of youths who actively participate in qualified cooperative education programs, who have attained the age of 16 but who have not attained the age of 19, and who have not graduated from high school or vocational school.

Issue

The issue is whether the targeted jobs credit should be extended to the hiring of youths participating in a qualified cooperative education program who have attained the age of 19 but who have not attained the age of 20.

Explanation of the bill

The bill would amend section 51(d) (8) (A) (i) of the Code to provide that the targeted jobs credit would be available for the hiring of youths who actively participate in qualified cooperative education programs, who have attained the age of 16 but who have not attained the age of 20, and who have not graduated from high school or vocational school.

Effective date

The provisions of the bill generally would be effective for taxable years beginning after December 31, 1978, for wages paid or incurred before the date set under present law for termination of the targeted jobs credit.[1] The provisions would be subject to the same transitional rules as section 321(a) of the Revenue Act of 1978.

Revenue effect

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

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[1] Under the Revenue Act of 1978, the targeted jobs credit applies to wages paid or incurred prior to 1981. As passed by the House, H.R. 2797 (the Technical Corrections Act of 1979) would extend the credit to apply to wages paid or incurred prior to 1982.

4. H.R. 4298—Mr. Rostenkowski

Special Rule for Certain Distributions From Money Purchase Pension plans

Present law

An employee who receives a lump sum distribution from a tax-qualified pension, profit-sharing, or stock bonus plan may defer tax on the distribution by rolling over the proceeds (net of any employee contributions) within 60 days of receipt (1) to an IRA (an individual retirement account, annuity, or bond), or (2) to another employer-sponsored qualified pension, etc., plan. The rollover rule also applies to the spouse of an employee who receives a lump sum distribution on account of the employee's death. A lump sum distribution from a qualified plan is eligible for favorable income tax treatment (e.g., 10-year income-averaging) if no portion of the distribution is rolled over.

A lump sum distribution is a distribution of the balance to the credit of an employee under a qualified pension, etc., plan, made within one taxable year of the recipient. Generally, the distribution must have been made on account of death, separation from service, or the attainment of age 59½. If an employer maintains more than one qualified plan of the same type, the plans are aggregated for the purpose of determining whether the balance to the credit of an employee has been distributed. Under the aggregation rules, all pension plans (defined benefit and money purchase) maintained by the employer are treated as a single plan, all profit-sharing plans maintained by the employer are treated as a single plan, and all stock bonus plans maintained by the employer are treated as a single plan.

Issue

The issue is whether a total distribution to an employee (or to the employee's spouse) from a money purchase pension plan should be eligible for rollover treatment if the employer also maintains a defined benefit pension plan covering the employee and a total distribution is not made from the defined benefit plan in the same taxable year.

Explanation of the bill

The bill would allow an employee who receives a total distribution from a money purchase pension plan to roll over the distribution to an IRA or to another qualified plan where the employer also maintains a defined benefit pension plan covering the employee and a total distribution is not made from the defined benefit plan in the same taxable year. The bill would also apply to the spouse of an employee if the spouse receives such a total distribution on account of the employee's death.

If the recipient rolls over a total distribution from a money purchase pension plan under the provisions of the bill and, in a subsequent taxable year, receives a total distribution from a defined benefit pension plan maintained by the employer, the later plan distribution could be rolled over tax-free but would not otherwise be eligible for the favorable income tax treatment accorded lump sum distributions.

Effective date

Generally, the provisions of the bill would apply to taxable years beginning after December 31, 1978. In the case of a distribution made before January 1, 1980, the period for making a rollover under the bill would not expire before December 31, 1980.

Revenue effect

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

5. H.R. 4446—Messrs. Holland, Conable, Duncan (Tenn.), Vander Jagt, Gradison, Jenkins, Ford (Tenn.), Bafalis, and Fowler

Method of Accounting for Railroad Track Assets

Present law

If a taxpayer acquires an asset with a useful life of more than one year for use in a trade or business or for the production of income, a current deduction of the cost generally is not allowed. Rather, the cost of the asset must be capitalized. If the asset is property which is subject to wear and tear, to decay or decline from natural causes, to exhaustion and to obsolescence, the acquisition cost (less salvage value in excess of 10-percent of cost) generally can be deducted over the asset's useful life either ratably or pursuant to a permissible "accelerated" method under which larger deductions are allowable in the earlier years of use. This approach to the recovery of the cost of an asset is referred to as depreciation.

The railroad industry, however, generally uses for tax purposes what is called the "retirement-replacement-betterment" (RRB) method of accounting for railroad track (rail) and ties, and other items in the track accounts such as ballast, fasteners, other materials and labor costs. Although the RRB method is not specifically recognized as an allowable method of depreciation or accounting under the Internal Revenue Code, it has been allowed in court decisions and is recognized by the Internal Revenue Service in revenue rulings.[1] The Service's recognition of this method for tax purposes is based upon the requirement by the Interstate Commerce Commission (ICC) that this method be used for rate-making purposes. Although the ICC now requires use of the RRB method, it is presently considering a change to require the use of ratable depreciation.

For assets accounted for under the RRB method, when a new railroad line is laid, the costs (both materials and labor) of the line are capitalized. No depreciation is claimed on the original installation, but these original costs may be written off if this line is retired or abandoned. If the original installation is replaced with components (track, ties, etc.) of a like kind or quality, the costs of the replacements (both materials and labor) are deducted as current expense. When the replacement is of an improved quality, it generally is treated as a betterment, under which the betterment portion of the replacement is capitalized and the remainder is expensed.[2] Where rail and other

[1] Rev. Rul. 67–22, 67–1 C.B. 52; Rev. Rul. 67–145, 67–1 C.B. 54; Rev. Rul. 78–199, 78–1 C.B. 66.

[2] Railroads may also claim the regular 10-percent investment credit on their track costs, including both costs which are capitalized as costs of a new line (or a betterment) and those which are currently deducted replacement costs (Code secs. 48(a)(1)(B) and 48(a)(9), Regs. § 1.48–1(d)(4)).

track assets are retired, the salvage value (measured by fair market value) of the recovered materials is reflected as ordinary income.[3]

The operation of the RRB method can be illustrated by the following examples. If the original installation of a new rail line included a railroad tie which cost $3, this cost is capitalized and no ratable depreciation is allowed. When this tie is replaced with a tie which currently costs $20, the $3 original cost remains frozen and the $20 replacement cost is deducted currently. Where a betterment is involved, for example, where 100-pound rail is replaced with 150-pound rail which costs $120, under the RRB method the betterment portion ($40)[4] is capitalized and the replacement portion ($80) is deducted currently.

Issue

The issue is whether the retirement replacement-betterment method of accounting for railroad track assets should be codified as an acceptable method of depreciation for Federal income tax purposes.

Explanation of the bill

The bill would codify the retirement-replacement-betterment method of accounting for railroad track assets as an acceptable method of depreciation for Federal income tax purposes.

Effective date

The provisions of the bill would be effective for taxable years ending after December 31, 1953 (the general effective date of the Internal Revenue Code of 1954).

Revenue effect

It is estimated that this bill will have no effect on budget receipts. The estimate is based on the assumption that the Internal Revenue Service would not, without this legislation, require a change in the method of accounting for tax purposes to a ratable depreciation method from the presently accepted retirement-replacement-betterment method.

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[3] See, e.g., *Seaboard Coast Line Railroad Company, Successor by Merger to Atlantic Coast Line Railroad Company* v. *Commissioner*, 72 T.C. ——, No. 76 (August 22, 1979).

[4] The $40 betterment portion is computed as follows:

$$\frac{\text{150-lb. new rail less 100-lb. old rail}}{\text{150-lb. new rail}} \times \text{\$120 cost of new rail} = \text{\$40}$$