[JOINT COMMITTEE PRINT]

DESCRIPTION OF LAW AND BILLS

RELATING TO

BUSINESS USE OF HOMES AND OTHER TAX MATTERS

SCHEDULED FOR A HEARING

BY THE

SUBCOMMITTEE ON SELECT REVENUE MEASURES

OF THE

COMMITTEE ON WAYS AND MEANS

ON OCTOBER 19, 1981

PREPARED FOR THE USE OF THE

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INTRODUCTION

The bills and matters described in this pamphlet have been scheduled for a public hearing on October 19, 1981, by the Subcommittee on Select Revenue Measures of the House Committee on Ways and Means.

There are eleven bills and one additional matter scheduled for the hearing. Six of the bills would modify the rules dealing with the business use of homes and rental of residences to family members (Code sec. 280A) : H.R. 588, H.R. 890, H.R. 1177, H.R. 1290, H.R. 1410, and H.R. 4071. Five of the bills relate to other subjects: H.R. 2295 (relating to the investment credit for educational filmstrips) ; H.R. 2397 (relating to the treatment of certain finance companies as personal holding companies) ; H.R. 2860 (relating to accrual of tax deductions after change in liability date) ; H.R. 3581 (relating to exclusion of certain foreign commodity income from foreign personal holding company income) ; and H.R. 4408 (relating to refunds of excise tax on buses). In addition, the hearing will address the expiration of the deferral of the effective date of the Tax Reform Act of 1976 amendments to the provision limiting net operating loss carryovers of corporations (Code sec. 382).

The first part of the pamphlet is a summary of the bills and matters covered by the hearing. This is followed by a more detailed description of the bills, including present law, issues, explanation of provisions, effective dates, and estimated revenue effects (except where indicated). The pamphlet then provides a description of the present status of the limitations on net operating loss carryovers of corporations and the issues raised by the termination of the deferral date on the effective date to the 1976 Act changes to these rules.

I. SUMMARY

A. Restrictions on Deduction for Business Use of Homes and Rental of Residences to Family Members (Code sec. 280A)

H.R. 588—Mr. Roybal; H.R. 890—Mr. Martin; H.R. 1177—Messrs. Pepper and Rousselot; H.R. 1290—Messrs Bafalis and Frenzel; H.R. 1410—Mr. Marriott; and H.R. 4071—Mr. Duncan

Section 280A, enacted as part of the Tax Reform Act of 1976, limits the deduction of certain expenses incurred in connection with the use of a dwelling in connection with a trade or business or income-producing activity of the taxpayer if the taxpayer also uses the dwelling for personal purposes. In determining whether a taxpayer uses a dwelling for personal purposes, the use of the dwelling by a co-owner or a member of the taxpayer's family is considered the personal use of the dwelling by the taxpayer, without regard to whether the co-owner or family member is renting the dwelling at a fair rental. Section 280A applies to taxable years beginning after December 31, 1975.

H.R. 588

Under H.R. 588, a family member's use of a dwelling would not be considered personal use by the taxpayer if the family member paid a fair rental, the family member was at least 60 years old, or the family member was permanently and totally disabled. The provisions would apply to taxable years beginning after December 31, 1980.

H.R. 890

Under H.R. 890, section 280A would not become effective until taxable years beginning after December 31, 1981.

H.R. 1177

Under H.R. 1177, the use of a dwelling by a member of the taxpayer's family would not be considered the personal use of the dwelling if the family member pays a fair rental. The provisions of H.R. 1177 would apply to all taxable years to which section 280A applies.

H.R. 1290

Under H.R. 1290, section 280A would provide explicitly that a taxpayer may have a principal place of business within his home for any separate trade or business. In addition, the bill would provide that the use of a dwelling by a family member would not be considered personal use by the taxpayer if the family member pays a fair rental. The bill also would prevent any ruling or regulation from treating a day on which the taxpayer is engaged on a substantially full-time basis in repair or maintenance work on a rental dwelling unit as a day of personal use because other individuals may not be similarly engaged in full-time work on that day. The provisions of the bill would apply to all taxable years to which section 280A applies.

H.R. 1410

Under H.R. 1410, section 280A would provide explicitly that a taxpayer may have a principal place of business within his home for any separate trade or business. The provisions of H.R. 1410 would apply to all taxable years to which section 280A applies.

H.R. 4071

Under H.R. 4071, limitations on the deductibility of expenses incurred in connection with the rental of a residence would not apply to rentals under a shared equity financing agreement, under which an owner of an interest in a dwelling uses the dwelling as a principal residence and pays the other owners of the dwelling a fair rental for their ownership interest. The provisions of H.R. 4071 would apply to taxable years beginning after December 31, 1980.

B. Other Tax Matters

1. H.R. 2295—Messrs. Downey, Porter, Ottinger, and Pickle

Investment Tax Credit for Educational Filmstrips

Present law generally provides that motion picture films and video tapes are eligible for a $6\frac{2}{3}$ percent investment tax credit if such films are created primarily for use as public entertainment or for educational purposes, provided that the market for these films is not primarily topical or essentially transitory in nature. The bill would include educational filmstrips in the definition of qualified films eligible for the investment credit, subject to the same rules governing the credit for other movies and films.

2. H.R. 2397—Mr. Holland

Treatment of Certain Finance Companies as Personal Holding Companies

Under present law, a tax is imposed on the undistributed personal holding company income of a personal holding company (Code sec. 541). Generally, personal holding company income includes interest. A corporation actively engaged in a lending or finance business is exempt from this tax if the corporation has qualifying business expenses equal to 15 percent of the first $500,000 of ordinary gross income from its lending or finance business, plus five percent of such ordinary gross income from $500,000 to $1 million. The term "lending or finance business" is defined to include the business of making loans with maturities of no more than 60 months.

The bill would increase the 60-month limitation of present law to 144 months, and would amend the definition of a lending or finance business to include the business of making certain types of revolving credit loans. The bill also would amend the business expense test of present law to require a lending or finance business to have qualifying business expenses equal to 15 percent of the first $500,000 of ordinary gross income from the lending or finance business, plus five percent of such ordinary gross income in excess of $500,000. Thus, the $1 million ordinary gross income amount would be eliminated for purposes of applying the qualifying business expense test.

The provisions of the bill would apply to taxable years beginning on or after December 31, 1980.

3. H.R. 2860—Mr. Stark

Accrual of Tax Deductions After Change in Liability Date

Under present law, if a taxing jurisdiction changes the assessment date for a deductible tax (e.g., a State or local property or income tax), an accrual basis taxpayer cannot accrue a deduction for that tax on the new assessment date because it would result in a deduction of two taxes in the year of change (i.e., the tax whose assessment date was not changed and the tax whose assessment date was changed). The taxpayer is required to continue to deduct the tax on the basis of the original assessment date.

The bill would allow the taxpayer to deduct the tax on the new assessment date for the year of change. However, for that same year, the taxpayer could not deduct the tax whose assessment date had not changed. This would avoid the result of the taxpayer having two tax deductions in one year.

4. 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.

5. H.R. 4408—Messrs. Schulze, Vander Jagt, Brodhead and Heftel

Refunds of Excise Tax on Buses

The 10-percent manufacturers excise tax on buses which had been imposed under prior law was repealed by the Energy Tax Act of 1978 for buses sold after November 9, 1978. The Act also established conditions under which a manufacturer is eligible for a credit or refund (without interest) for the excise tax paid on a bus sold to an ultimate purchaser after April 19, 1977.

The bill would liberalize these conditions for eligibility to allow additional refunds of the bus excise tax. It also would require payment of interest on certain additional amounts refunded.

6. Section 9(e), Public Law 96–167

Expiration of the Deferral of the Effective Dates Relating to Special Limitations on Net Operating Loss Carryovers of Corporations (Code Sec. 382)

The Tax Reform Act of 1976 substantially revised the rules in section 382 limiting net operating loss carryovers of corporations that undergo a substantial change of ownership through stock purchases or reorganizations. In general, the 1976 Act amendments impose comparable continuity of interest requirements on the shareholders of the loss corporation, whether change in ownership results from stock purchase or from a reorganization and eliminates a continuity of business enterprise requirement applicable only where change in ownership results from purchases. The effective date of the 1976 Act amendments was deferred because of technical problems respecting those provisions. As deferred, the amendments without further Congressional action will become effective on January 1, 1982, with respect to plans of reorganization adopted on or after that date and on June 30, 1982, with respect to sales or exchanges of stock after that date, in taxable years beginning after that date.

II. DESCRIPTION OF BILLS

A. Bills Relating to Restrictions on Deductions for Business Use of Homes and Rental of Residences to Family Members (Code sec. 280A)

H.R. 588—Mr. Roybal; H.R. 890—Mr. Martin; H.R. 1177—Messrs. Pepper and Rousselot; H.R. 1290—Messrs. Bafalis and Frenzel; H.R. 1410—Mr. Marriott; and H.R. 4071—Mr. Duncan

Present Law

In general

Section 280A, enacted as part of the Tax Reform Act of 1976, disallows the deduction of certain expenses incurred in connection with the use of the taxpayer's home in a trade or business or income producing activity or in connection with the rental of vacation homes and other residential real estate. The restrictions in section 280A were enacted to replace vague standards on which courts and the Internal Revenue Service differed with more definitive, objective statutory tests for determining the deductibility of expenses. Section 280A applies to individuals, trusts, estates, partnerships and electing small business corporations.

The deductions under sections 163, 164 and 165 for interest, certain taxes, and casualty losses attributable to a taxpayer's personal residence are not affected by section 280A.

Business use of the home

Unless specifically excepted from section 280A and otherwise allowable, no deductions are allowed with respect to a dwelling unit because of its connection to a taxpayer's trade or business or income producing activities, if the taxpayer uses the dwelling as a residence. One exception to the general rule of section 280A allows deductions attributable to a portion of the taxpayer's residence which is exclusively used on a regular basis as the taxpayer's principal place of business.

On August 7, 1980, proposed Treasury Regulations under section 280A were published in the Federal Register (45 Fed. Reg. 52399). The proposed regulations would define "the taxpayer's principal place of business" as the principal place of the taxpayer's overall business activity. A taxpayer would have only one principal place of business regardless of the number of business activities in which the taxpayer is engaged. The proposed regulations do not follow the U.S. Tax Court decision in *Curphey* v. *Commissioner*, 73 T.C. 766 (1980), which allowed a hospital-employed dermatologist to deduct expenses for a home office which was the principal place of business for his real estate rental business.

Personal use of residence

Section 280A, in general, limits the amount a taxpayer may deduct for expenses attributable to the rental of a dwelling unit, in many cases a vacation home, if the taxpayer uses the unit for personal purposes in excess of a specified period of time during a taxable year. This limitation applies only if the taxpayer's use of the dwelling unit for personal purposes during a taxable year exceeds the greater of fourteen days or ten percent of the number of the days during the year for which the unit is rented. If a taxpayer exceeds these personal use limitations, deductions attributable to the rental activity are limited to the amount by which the gross income derived from the rental activity exceeds the deductions otherwise allowable without regard to such rental activities (*e.g.*, interest and certain taxes).

In the case of an individual or subchapter S corporation, if the taxpayer uses a dwelling for personal purposes during a taxable year (whether or not the personal use exceeds the personal use limitations), the amount deductible with respect to the expenses attributable to the rental of the dwelling is limited to a portion of such expenses, based on the number of days the dwelling is rented at a fair rental compared to the total number of days the dwelling is used during the taxable year.

Family rentals and rentals to co-owners.—The taxpayer generally is deemed to have used a dwelling unit for personal purposes for a day if, for any part of the day, the unit is used for personal purposes by (1) the taxpayer or any other person who owns an interest in the home; (2) the brothers and sisters, spouse, ancestors, or lineal descendants of the taxpayer or other owners; (3) any individual who uses the unit under a reciprocal arrangement (whether or not a rental is charged); or (4) any other individual who uses the dwelling unit during a day unless a fair rental is charged.

The Revenue Act of 1978 amended section 280A to provide that the use of a dwelling unit as a taxpayer's principal residence (within the meaning of section 1034) is not to be treated as personal use in determining whether the limitations of section 280A apply to deductions attributable to a "qualified rental period" which immediately precedes or follows a period of use as the taxpayer's principal residence. Under section 280A, a qualified rental period generally is a period of 12 or more consecutive months during which the unit is rented to a person other than a family member, or held for rental, at a fair rental.

Repairs and maintenance.—Section 280A also provides that the Secretary of the Treasury must prescribe by regulation the circumstances under which use of a dwelling unit for repairs and annual maintenance will not constitute personal use of the unit. Under the proposed regulations published on August 7, 1980, an individual would have to be engaged in repair or maintenance work for a day on a substantially full-time basis, *i.e.*, the lesser of eight hours or two-thirds of the time present on the premises, to qualify the day's use of the unit as use for repairs and maintenance. The proposed regulations would require that all individuals on the premises on a day must be engaged in work on the unit on a substantially full-time basis, to avoid the day being treated as one of personal use. However, the proposed regulations would disregard the presence of individuals, such as small children, who are incapable of working.

Issues

The principal issues are, (1) whether business expenses attributable to the use of a portion of a taxpayer's residence as the principal place of business for a separate, secondary business of the taxpayer, should be subject to the general rule of section 280A disallowing deductions for such expenses, (2) whether rental of a taxpayer's principal residence or another dwelling to a family member at a fair rental price should be treated in the same manner as a rental to an unrelated party, (3) whether regulations should treat a taxpayer as having used a dwelling for personal purposes if the taxpayer spends a normal working day repairing or maintaining the dwelling while other persons, who are capable of working, use the dwelling for personal purposes, and (4) whether rental to a co-owner at a fair rental should be treated the same as a rental to an unrelated party where the co-owner uses the dwelling as his principal residence.

Explanation of Bills and Effective Dates

1. H.R. 588—Mr. Roybal

Under the bill, section 280A(d)(2) would be amended to provide that the use of a dwelling by a member of the taxpayer's family (or the family of any other person with an interest in the dwelling) does not constitute personal use of the dwelling by the taxpayer if the family member pays a fair rental for the dwelling, is at least 60 years old, or is permanently and totally disabled.

Under section 280A(d)(3), a taxpayer's use of a dwelling as a principal residence is not considered personal use for any period immediately before or after a "qualified rental period." The bill would provide that a "qualified rental period" is a period of 12 or more months (or less than 12 months if the dwelling is sold or exchanged at the end of the period) for which a taxpayer's principal residence is rented or is held for rental at a fair rental, regardless of whether the dwelling is rented to a member of the taxpayer's family or an unrelated person.

The provisions of H.R. 588 would apply to taxable years beginning after December 31, 1980.

2. H.R. 890—Mr. Martin

Under the provisions of H.R. 890, the effective date of section 280A would be amended to postpone the application of section 280A until taxable years beginning after December 31, 1981.

3. H.R. 1177—Messrs. Pepper and Rousselot

The provisions of H.R. 1177 would provide two amendments to section 280A that would treat fair-market rentals to family members in the same way as rentals to unrelated parties, thereby allowing deductions for expenses attributable to such rentals. Section 280A(d)(2) would be amended so that the use of a dwelling by a member of the family of either the taxpayer or any other person with an interest in the dwelling would not be considered the personal use of the dwelling by the taxpayer if the dwelling is rented to the family member at a fair rental.

Under section 280A(d)(3), a taxpayer's use of a dwelling as a principal residence is not considered personal use for any period immediately before or after a "qualified rental period." The bill would provide that a "qualified rental period" is a period of 12 or more months (or less than 12 months if the dwelling is sold or exchanged at the end of the period) for which a taxpayer's principal residence is rented or is held for rental at a fair rental, regardless of whether the dwelling is rented to a member of the taxpayer's family or an unrelated person.

The provisions of H.R. 1177 would apply to taxable years beginning after December 31, 1975, the taxable years to which section 280A applies.

4. H.R. 1290—Messrs. Bafalis and Frenzel

This bill contains three amendments to section 280A and a provision relating to rulings and regulations of the Internal Revenue Service concerning use of a dwelling for maintenance and repair.

The bill would amend section 280A(c)(1)(A) to provide that the general limitation on deductions in section 280A(a) shall not apply to expenses allocable to the regular and exclusive use of a portion of a taxpayer's residence as a principal place of business for any trade or business of the taxpayer. Thus, a taxpayer could have a distinct principal place of business for each separate trade or business and could deduct expenses attributable to the use of a residence as the principal place of business for one or more such businesses, provided the regular and exclusive use requirements are met.

Two amendments would treat fair-market rentals to family members in the same way as rentals to unrelated parties, thus allowing deductions for expenses attributable to such rentals. Section 280A(d)(2) would be amended so that the use of a dwelling by a member of the family of either the taxpayer or any other person with an interest in the dwelling would not be considered the personal use of the dwelling by the taxpayer if the dwelling is rented to the family member at a fair rental.

Under section 280A(d)(3), a taxpayer's use of a dwelling as a principal residence is not considered personal use for any period immediately before or after a "qualified rental period." The bill would provide that a "qualified rental period" is a period of 12 or more months (or less than 12 months if the dwelling is sold or exchanged at the end of the period) for which a taxpayer's principal residence is rented or is held for rental at a fair rental, regardless of whether the dwelling is rented to a member of the taxpayer's family.

The bill also would provide that, notwithstanding any ruling, proposed regulation, or regulation to the contrary, a dwelling would not be treated as used for the personal purposes of the taxpayer on a day the taxpayer repairs or maintains the dwelling on a substantially full-time basis because other persons, who are on the premises and who are capable of working, do not work on a substantially full-time basis.

The provisions of H.R. 1290 would apply to taxable years beginning after December 31, 1975, the taxable years to which section 280A applies.

5. *H.R. 1410—Mr. Marriott*

The bill would amend section 280A(c)(1)(A) to provide that the general limitation on deductions in section 280A(a) shall not apply to expenses allocable to the regular and exclusive use of a portion of a taxpayer's residence as a principal place of business for any trade or business of the taxpayer. Thus, a taxpayer could have a distinct principal place of business for each separate trade or business and could deduct expenses attributable to the use of a residence as the principal place of business for one or more such businesses, provided the regular and exclusive use requirements are met.

The bill would also amend section 280A to provide that fair-market rentals to family members will be treated in the same manner as rentals to unrelated persons. Section 280A(d)(2) would be amended to provide that fair market rentals to members of the taxpayer's family (or the family of any other person with an interest in the dwelling) will not be considered the personal use of the dwelling by the taxpayer. Section 280A(d)(3) would be amended to provide that a "qualified rental period" includes a period for which a dwelling is rented at a fair rental, regardless of whether the dwelling is rented to a member of the taxpayer's family or an unrelated person.

The provisions of H.R. 1410 would apply to taxable years beginning after December 31, 1975, the taxable years to which section 280A applies.

6. *H.R. 4071—Mr. Duncan*

Under H.R. 4071, the limitations of section 280A(c)(5) and 280A(e) on the deduction of expenses attributable to the rental of a dwelling would not apply to deductions attributable to the rental of a dwelling under a shared equity financing agreement. A shared equity financing agreement would be defined as an agreement under which two or more persons acquire interests in a dwelling and one or more of the owners occupies the dwelling as a personal residence and pays the nonresident owners a fair rental for the dwelling (after taking into account the occupant's ownership interest).

However, the use of the dwelling under a shared equity financing agreement would continue to constitute the personal use of the dwelling by each of the persons with an ownership interest in the dwelling. Therefore, such dwelling would be considered as being used for personal purposes by each of such persons and generally would be considered as used as a residence by each of such persons. Therefore, the limitations of section 280A would apply to limit the deductibility of expenses attributable to all other business uses of such dwelling by the co-owners.

The provisions of H.R. 4071 would apply to taxable years beginning after December 31, 1980.

Revenue Effect

Estimates of the revenue effects of these bills are not available at this time.

B. Other Tax Matters

1. H.R. 2295—Messrs. Downey, Porter, Ottinger, and Pickle

Investment Tax Credit for Educational Filmstrips

Present Law

Under present law, taxpayers are entitled to a 10-percent tax credit for investments in tangible personal property and certain other tangible property used in a trade or business or for the production of income (i.e., section 38 property). Under the investment credit rules, the amount of the credit depends upon the period the property is held by the taxpayer. However, prior to 1976, the eligibility of movie and television films for the investment credit and the determination of the amount of the credit for such films was unclear.

In the Tax Reform Act of 1976, Congress provided rules to clarify the application of the investment tax credit to movie and television films. Under these rules, a 6⅔ percent credit is generally available for a "qualified film" regardless of the useful life (or foreign use) of the property, unless the taxpayer elects to have the amount of the credit computed on a film-by-film basis under the 90-percent rule.[1] A "qualified film" is defined as any motion picture film or video tape created primarily for use as public entertainment or for educational purposes, the market for which is not primarily topical or essentially transitory in nature.

Generally, films used in primary or secondary schools, colleges and universities, vocational and post-secondary educational institutions, public libraries and government agencies qualify for the investment credit. Films and tapes created primarily for use by industrial and commercial organizations, such as advertisements and industrial training films and tapes do not qualify for the credit. A film or tape is topical or essentially transitory if it primarily deals with events and personalities of current interest at the time the film or tape is placed in service. Thus, news shows such as the evening news and news specials relating to current affairs, interview shows such as "The Tonight Show" or "Meet the Press," game shows, award shows, and sporting event shows do not qualify for the credit. The 1976 Act rules apply to films placed in service in taxable years beginning after December 31, 1974.

[1] Under the 90-percent rule, the amount of the investment credit for each qualified film is determined under the normal investment credit rules with the end of the useful life of each film considered to occur at the end of the year in which the total allowable depreciation deduction is equal to at least 90 percent of the basis of the film.

Educational filmstrips are similar to educational motion picture films except that, in the case of the filmstrip, the film consists of individual slides or frames rather than one continuous series of action. The regulations issued by the Treasury Department provide that a film or tape includes the original negative or tape, duplicate negatives and all sound recordings created to simultaneously accompany the pictorial material. Treas. Reg. sec. 1.48–8(a)(3). These regulations do not indicate whether educational filmstrips qualify for the special rules for qualified films.

Issue

The issue is whether educational filmstrips should be eligible for the investment tax credit and, if so, what should be the effective date of the amendment.

Explanation of the Bill

The bill would clarify the definition of "qualified film" to include educational filmstrips. Educational filmstrips would be subject to the same rules governing the investment credit for other movies and films.

Effective Date

The provisions of the bill would apply to taxable years beginning after December 31, 1974.

Revenue Effect

It is estimated that this bill would reduce budget receipts by $2 million per year for fiscal years 1982 through 1986.

2. H.R. 2397—Mr. Holland

Treatment of Certain Finance Companies as Personal Holding Companies

Present Law

In general

Code section 541 imposes a tax on the undistributed personal holding company income of a personal holding company. This provision is intended to prevent individuals from avoiding the graduated individual tax rates (up to 70 percent before the effective date of the Economic Recovery Tax Act of 1981 (ERTA)) by holding investments through corporations, which are subject to a maximum tax rate of 46 percent. Accordingly, prior to the effective date of ERTA, the personal holding company tax is 70 percent of undistributed personal holding company income. However, pursuant to ERTA section 101(d)(2), the applicable tax rate is 50 percent for taxable years beginning after December 31, 1981.

A corporation constitutes a personal holding company if 60 percent of its adjusted gross income is personal holding company income and if 50 percent of its stock is owned by five or fewer shareholders at any time during the last half of the taxable year. Personal holding company income generally is defined as interest, dividends, royalties, rents, and certain other types of passive investment income.

Exclusion for lending, finance companies

Certain types of corporations, actively engaged in a trade or business which produces income that usually would be considered passive investment income, are excluded from the personal holding company tax provisions. Among the corporations excluded from these provisions are lending or finance companies.

A corporation qualifies as a lending or finance company if 60 percent of its ordinary gross income is derived from the active and regular conduct of a lending or finance business and certain other requirements are satisfied. The term "lending or finance business" is defined, in part, to mean a business of making loans, or purchasing or discounting accounts receivable, notes, or installment obligations, which at the date of the loan or acquisition have a remaining maturity of no more than 60 months. An exception to the 60-month rule is provided for loans, notes, or obligations secured by a security interest in personal property where the security interest arose out of the sale of goods or services in the course of the borrower's or transferor's trade or business.

The personal holding company provisions also apply a business expense test in determining whether a corporation is engaged in the active and regular conduct of a lending or finance business. Under this requirement, a corporation does not qualify as a lending or finance company exempt from the personal holding company provisions unless the sum of its business expenses directly allocable to its lending or finance business equals or exceeds 15 percent of the first $500,000 of its ordinary gross income derived from a lending or finance business plus five percent of such ordinary gross income from $500,000 to $1 million.

Issues

The issues are whether to broaden the exclusion from personal holding company status for lending or finance businesses to include the business of making revolving credit loans or loans with maximum maturities of 144 months, and whether to modify the business expense test in determining whether a corporation is engaged in the active and regular conduct of a lending or finance business.

Explanation of the Bill

The bill would modify both the 60-month maturity limitation and the business expense requirement of the lending or finance company exception to the personal holding company provisions.

Under the bill, the definition of a lending or finance business would be broadened to include the business of making loans with maturities up to 144 months and to include the business of making certain types of revolving credit loans. Revolving credit loans qualifying under the bill would be such loans made under an agreement which provides that the creditor will make loans or advances (not in excess of an agreed upon maximum amount) from time to time for the account of the debtor upon request and which provides that the debtor may repay the loan, advance, or installment obligation in full or in installments.

The bill also would modify the amount of business expenses required in determining whether a corporation with more than $1 million in ordinary gross income from a lending or finance business is a lending or finance company. Under the bill, a corporation would satisfy the business expense test only if its qualifying business expenses equal or exceed 15 percent of the first $500,000 of ordinary gross income derived from a lending or finance business, plus five percent of such ordinary gross income in excess of $500,000.

Effective Date

The provisions of the bill would apply to taxable years beginning on or after December 31, 1980.

Revenue Effect

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

Prior Congressional Action

A similar provision was included in H.R. 7171 (96th Congress) as reported by the Finance Committee (Sen. Rep. 96–1032) and passed by the Senate on December 13, 1980. That provision was deleted by the House in agreeing to H.R. 7171 on December 13, 1980.

3. H.R. 2860—Mr. Stark

Accrual of Tax Deductions After Change in Liability Date

Present Law

Under the accrual method of accounting, an expense is deductible for the taxable year in which all the events have occurred which determine the fact of the liability and the amount of the deduction can be determined with reasonable accuracy. However, present law also provides that, if a taxing jurisdiction changes the time for imposing a deductible tax so that the tax would be deductible in an earlier period under the above rule, an accrual basis taxpayer may not deduct the tax in the earlier period. Instead, the taxpayer may deduct the tax in the period that the tax would have otherwise been deductible if the taxing jurisdiction had not changed the time for imposing the tax.

This provision was enacted to prevent taxpayers from getting two tax deductions in one year because the taxing jurisdiction accelerated the assessment date of a tax. Thus, if a property tax lien date was January 1, of each year and in 1980 the local tax jurisdiction changed the lien date for 1981 and all years thereafter to December 31, the taxpayer would get two tax deductions in 1980—one for the January 1, 1980 lien which was not changed and one for the December 31, 1980 lien date which was changed from January 1, 1981. In this situation, present law would require that an accrual basis taxpayer ignore the change of lien dates and accrue a deduction in accordance with the law before the change, i.e., January 1, 1981.

Issue

The issue is whether a taxpayer should be allowed a deduction for taxes where the liability date of the tax has been changed, but the possibility of deductions for two years' taxes is removed through use of a suspense account.

Explanation of the Bill

The bill would allow a taxpayer to elect to accrue a deduction for taxes where the liability date of the tax (i.e., the date the tax is accrued under Federal income tax accounting principles) has been changed to an earlier date ("postchange tax") by the appropriate tax jurisdiction. However, the bill still eliminates the possibility of two tax deductions in the year of change by not allowing the taxpayer to deduct the tax that accrues in the year of change or, if greater, the tax in one of the two preceding taxable years (see discussion below) under the law of the taxing jurisdiction before the change in the liability date ("pre-change tax"). For example, in the illustration in *Present Law*, the taxpayer would be allowed to deduct the tax having the lien date of December 31, 1980 and would not be allowed to deduct the tax with the lien date of January 1, 1980.

The denial of the deduction for the pre-change tax is accomplished through a suspense account. A suspense account is an account that records the expenditure for the tax but not in an expense account. Under the bill the greater of the pre-change tax or the tax accrued in either of the two preceding years is placed in a suspense account. If the prechange tax is the greater tax and is thus entered in the suspense account it results in a denial of a deduction for that tax. If the tax in one of the two preceding taxable years in the greater tax and is thus entered in the suspense account, it results is a denial of a deduction to the extent of the pre-change tax and in an inclusion in income of the excess of the greater tax over the pre-change tax in order to offset the deduction of the greater tax in the earlier year.

The bill also provides that the suspense account will be reduced if the tax deduction in any of the post-change years is less than the amount in the suspense account. The effect of this reduction will be to allow a deduction for the amount of the reduction. (If the tax under consideration is an income tax, then the reduction in the suspense account, and the resulting deduction, is calculated using the greater of the tax deduction for the current year or the deduction for either of the two preceding years.) However, if the amount of any subsequent tax liability exceeds the amount of the suspense account the amount of that excess will be added to the suspense account until the amount in the suspense account equals the amount originally entered in the suspense account. The amount of the addition to the suspense account is treated as income for that year.

The bill also provides that if a taxpayer has never been liable for a pre-change tax in the taxing jurisdiction but has only been liable for post-change taxes, then the taxpayer will not have to establish a suspense account but may accrue the post-change tax on the new liability date. This would occur in a situation where a corporation is organized after the liability date of a tax is changed so that there is no chance that it could accrue two tax deductions in one year.

The election under this bill can be made for any taxable year if made within the time period prescribed for filing the tax return for that year (including extensions). Although the manner of making the election is to be prescribed by the Secretary in regulations, the election does not have to be made with the consent of the Secretary. The election will be binding for the taxable year in which it is made and for all subsequent taxable years unless the taxpayer secures the consent of the Secretary to revoke the election.

The bill also directs the Secretary to prescribe regulations which treats taxes that are enacted as a substitute for a substantially similar tax as the same tax. Also, nonrecognition transactions under Subchapter C of the Code are to be dealt with in regulations.

Effective Date

The bill would apply only to the actions of taxing jurisdictions taken after the date of enactment of this bill. However, if the taxpayer makes an election within his first or second taxable year after the bill's date of enactment with respect to an income tax (or a franchise tax based on income) which the taxpayer first became subject to after the change of the liability date and he has consistently accrued the tax deduction on the new liability date, then the taxpayer could elect to continue accruing the tax deduction on the new liability date. Also, the taxpayer does not have to establish a suspense account. Essentially, this election allows taxpayers who were never subject to the pre-change tax, and thus would not have gotten two tax deductions in one year, to continue to deduct the tax on the new liability date. Thus, in this case the effective date of the bill would be retroactive to the date the taxpayer first became liable to the post-change tax.

Revenue Effect

It is estimated that this bill would reduce fiscal year receipts by $54 million in 1982, $111 million in 1983, $124 million in 1984, $136 million in 1985 and $150 million in 1986.

4. 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

The revenue effect of the bill on budget receipts is not known at this time.

5. H.R. 4408—Messrs. Schulze, Vander Jagt, Brodhead, and Heftel

Refunds of Excise Tax on Buses

Present Law

Present law imposes no manufacturers excise tax on buses sold by a manufacturer, producer or importer (Code sec. 4063(a)(6)). The 10-percent manufacturers excise tax on buses which had been imposed under prior law was repealed by the Energy Tax Act of 1978 for buses sold after November 9, 1978.

The Act also contains provisions which effectively allow, under certain conditions, exemption from the excise tax for a bus sold to an ultimate purchaser after April 19, 1977, and before November 10, 1978. Under these provisions, a manufacturer, producer, or importer is allowed a credit or refund (without interest) for the tax paid on a bus if—

(1) he possesses evidence of sale to the ultimate purchaser and of reimbursement of tax to that purchaser;

(2) he files a claim for credit or refund with the Secretary of the Treasury before September 1, 1979; and

(3) the ultimate purchaser is reimbursed before September 5, 1979, for the tax paid on the bus.

Issue

The principal issue is whether the refund provisions should be broadened to allow refunds up to January 1, 1983, where the taxpayer was not eligible for the refund under the present rules because the taxpayer had not reimbursed the ultimate purchaser. A subsidiary issue is whether interest should be allowed on such refunds where the interest is passed on to the ultimate purchaser.

Explanation of the Bill

In general, the bill would amend the Energy Tax Act of 1978 to broaden the conditions under which a manufacturer, producer, or importer is eligible for a credit or refund of the manufacturers excise tax paid on a bus that was sold to an ultimate purchaser after April 19, 1977, and before November 10, 1978. However, the bill would not amend the present law requirement that a manufacturer have filed a claim for credit or refund with the Secretary of the Treasury before September 1, 1979.

Under the bill, the date before which the ultimate purchaser must have been reimbursed would be extended from September 2, 1979, to January 1, 1983. Second, the bill would allow a manufacturer to reimburse an ultimate purchaser simultaneously with the manufacturer's receipt of a refund of tax from the Treasury, in lieu of the present law requirement that the manufacturer possess evidence of reimbursement. Third, in the case of an "eligible claim," interest would be paid by the Treasury on an amount credited or refunded to a manufacturer (as if an overpayment had been made on September 1, 1979), if the manufacturer pays the interest received to the ultimate purchaser. For this purpose, an eligible claim would mean any claim for credit or refund which was filed before September 1, 1979, but which was not allowed or made solely by reason of the failure to make reimbursement of the tax to the ultimate purchaser before September 5, 1979.

It is understood that certain customers of Harbison Ford, Inc., of Morrisville, Pennsylvania, would be the principal beneficiaries of the bill, although there may be additional beneficiaries.

Effective Date

The introduced bill does not contain an effective date.

Revenue Effect

It is estimated that this bill would reduce budget receipts by less than $1 million for the fiscal years 1982 and 1983.

6. Section 9(e), Public Law 96–167

Expiration of the Deferral of the Effective Dates Relating to Special Limitations on Net Operating Loss Carryovers of Corporations (Code sec. 382)

Present Law

Prior to enactment of the Tax Reform Act of 1976, generally, if new owners purchased 50 percent or more of the stock of a loss corporation during a two-year period, the corporation's loss carryovers from prior years were allowed in full only if the corporation continued to conduct its prior trade or business or substantially the same kind of business. Generally, if the same business was not continued, however, loss carryovers were completely lost. This "purchase" rule applied where one or more of the 10 largest shareholders increased their stock ownership, within a two-year period, by 50 percentage points or more in a transaction in which the purchasers took a cost basis in their stock (except where the stock was acquired from "related" persons).

In the case of a tax-free reorganization, loss carryovers were allowed on a declining scale. If the former owners of the loss company received 20 percent or more of the fair market value of the stock of the acquiring company, the loss carryovers were allowed in full. For each percentage point less than 20 which the former owners received, the loss carryover was reduced by five percent. It was immaterial whether the business of the loss company was continued after the reorganization.

The 1976 Act extensively revised the Code provisions dealing with the carryover of net operating losses in cases of acquisitions of loss corporations. The limitations on loss carryover attributes were to apply to acquisitions made by purchase or through corporate reorganizations. The new provisions changed the basic concepts underlying the rules by deleting continuity of business requirements for purchases and establishing a new continuity of ownership test applicable to both purchases and reorganizations.

These new provisions were to apply to plans of reorganization adopted on or after January 1, 1978, and to sales or exchanges in taxable years beginning after June 30, 1978. However, the Revenue Act of 1978 extended these effective dates to January 1, 1980, and June 30, 1980, and Public Law 96–167 again extended them until January 1, 1982, with respect to plans of reorganization adopted on or after that date, and until June 30, 1982, with respect to sales or exchanges occurring in taxable years beginning after that date. These delays of the effective dates of the 1976 Act provisions were adopted to give Congress additional time to review a number of technical problems as well as to consider additional revision of the rules.

Issues

The principal issue is whether the 1976 Act provisions limiting net operating loss carryovers should be permitted to become effective in 1982 under the effective date provisions of existing law; and, further, if so, whether there should be technical revision of these provisions. Alternative solutions are to continue the existing limitations of section 382 permanently or to again continue them for a limited period of time during which other approaches can be considered.

Revenue Effect

It is estimated that allowing the 1976 Act amendment to become effective would increase budget receipts in light of the reduced offset of past losses against current profits. However, the amount of the revenue increase is considered indeterminate because the amount of the reduction in the use of carryovers depends on the relative sizes of the companies involved and also on the extent to which some acquisitions of loss companies by profitable companies may not be made.

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