[COMMITTEE PRINT]

DESCRIPTION OF ADDITIONAL PROPOSED AMENDMENTS TO H.R. 6715

PREPARED FOR THE USE OF THE

COMMITTEE ON WAYS AND MEANS

BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

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I. Introduction

This pamphlet describes additional proposed amendments to certain provisions enacted by the Tax Reform Act of 1976 (Public Law 94–455). The proposed amendments contained in this pamphlet were submitted by Members of the Ways and Means Committee to a screening committee appointed by Chairman Ullman and were approved by the screening committee for consideration in connection with H.R. 6715.

Section II of this pamphlet is organized in three parts: Part A relates to the technical amendments to income tax and administrative provisions; Part B relates to technical and conforming amendments to the estate and gift tax provisions; and Part C summarizes the clerical corrections and cross-reference changes.

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II. DESCRIPTION OF THE BILL

A. TECHNICAL AMENDMENTS TO INCOME TAX AND ADMINISTRATIVE PROVISIONS (SEC. 2 OF THE BILL)

1. Treatment of Community Property in the Case of Credit for the Elderly (sec. 503 of the Act, sec. 37(e) of the Code)

Prior law

The retirement income credit generally was 15 percent of the first $1,524 of retirement income ($2,286 of retirement income for those filing joint returns) for individuals age 65 and over. Individuals under age 65 are eligible for the credit with respect to pensions received under a public retirement system.

1976 Tax Reform Act

The 1976 Act simplified and expanded the credit generally but for public retirees under age 65 the credit was generally left the same as under prior law (with an increase in the amount of income eligible for the credit).

Issue

The amount of retirement income credit for public retirees where one spouse is under age 65 with the other spouse age 65 or over depends in part on each individual's public retirement income, the amount of any other income and which spouse received the income. These amounts differ depending on whether the retiree lives in a community property State or a common law State. The issue is whether or not those public retirees and their spouses living in community property States should receive the credit under different rules than those living in other States.

Proposed amendment

The amendment would disregard community property rules in determining eligibility and in computing the retirement income credit for public retirees and their spouses.

Revenue effect

It is estimated that this amendment would result in an annual increase of $1 million in fiscal year budget tax receipts for fiscal years 1978 through 1982.

Departmental position

The Treasury Department supports the proposed amendment.

2. Application of the Minimum Tax on Charitable Split-interest Trusts (sec. 301 of the Act, sec. 57 of the Code)

Prior law

Prior to the 1976 Act, all individuals (and trusts and estates) were subject to a minimum tax on their tax preference items.

1976 Tax Reform Act

The 1976 Act created a new tax preference by adding itemized deductions to the list of tax preferences to the extent they exceed 60% of adjusted gross income for purposes of the minimum tax. Generally, the Act includes charitable deductions that are included as an itemized deduction of trusts and estates for purposes of determining if there are "excess" itemized deductions treated as a preference under the minimum tax.

H.R. 6715

H.R. 6715 provides that the charitable deduction is not to be considered as an itemized deduction in the case of estates and wholly charitable trusts described in sec. 4947(a)(1).

Issue

The issue is whether the charitable deduction by a trust should be taken into account in determining preferences for excess itemized deductions where the trust is a charitable split-interest trust or is a wholly charitable trust which is not described in section 4947(a)(1).

Proposed amendments

The proposed amendment would provide that the charitable deduction is not an itemized deduction for purposes of the minimum tax in the case of certain charitable split-interest trusts (described in section 4947(a)(2)) and wholly charitable trusts.

Revenue effect

It is estimated that this amendment will result in an annual decrease of $5 million in fiscal year budget tax receipts for fiscal years 1978 through 1982.

Departmental position

The Treasury Department supports the proposed amendment that the charitable deduction is not an itemized deduction for purposes of the minimum tax in the case of wholly charitable trusts. The Department further believes that charitable split-interest trusts described in section 4947(a)(2) other than charitable income trusts established after October 4, 1976 (the effective date of the Tax Reform Act of 1976) should be granted similar treatment.

3. Historic Structures (sec. 2124 of the Act, sec. 191 of the Code)

Prior law

Prior law contained no special rules permitting rapid amortization or accelerated depreciation for expenditures incurred in the rehabilitation of historic structures.

1976 Tax Reform Act

The 1976 Act provides for 5-year amortization of certified rehabilitation expenses or, alternatively, special accelerated depreciation for certified historic structures. A certified historic structure is defined as a depreciable structure listed in the *National Register*, a depreciable structure located in a district listed on the *National Register* if the Secretary of the Interior certifies that the structure is of historic significance to the district, or a depreciable structure located in a State or locally designated historic district which meets certain tests. The

Act does not require that State or locally designated districts satisfy the criteria for a listing on the *National Register* or that structures be of historic significance to the districts, but it limits the tax benefits to situations where the rehabilitation is certified by the Secretary of the Interior as being consistent with the historic character of the building or district.

H.R. 6715

H.R. 6715 would conform the definition with respect to structures located in State or locally designated districts with the rules applicable to Federally designated districts by providing that structures in these districts are certified historic structures only where the district substantially satisfies the criteria for listing in the *National Register* and the Secretary of the Interior certifies that the structure is of historic significance to the district.

Issue

The first issue is whether it is appropriate to limit the 5-year amortization or the special accelerated depreciation provisions to rehabilitations of buildings located in State or locally designated historic districts to only those buildings which are of historic significance.

The second issue is whether there should be any requirement that State or locally designated historic districts meet substantially all the requirements for listing in the *National Register.*

Proposed amendment

The proposed amendment would delete the changes made by H.R. 6715. Thus, 5-year amortization of certified rehabilitation expenditures or, alternatively, special accelerated depreciation would be allowed with respect to any structure within a State or locally designated historic district. In addition, there would be no requirement that State or locally designated districts meet substantially all the criteria for listing in the *National Register.*

Revenue effect

It is estimated that adoption of this amendment will reduce budget receipts by less than $2 million annually.

Departmental position

The Treasury Department opposes the proposed amendment.

4. Deduction for Attending Foreign Convention (sec. 602 of the Act, sec. 274(h) of the Code)

Prior law

Prior to the 1976 Act, a deduction was allowed for traveling expenses paid or incurred to attend a foreign convention if the traveling expenses were reasonable and necessary in the conduct of the taxpayer's business and directly attributable to the trade or business. The lack of specific detailed requirements created substantial administrative problems for the IRS.

1976 Tax Reform Act

The 1976 Act provided specific rules limiting the deduction for expenses of attending conventions, seminars or similar meetings held outside the United States, its possessions, and the Trust Territory of

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the Pacific. The new rules apply to conventions beginning after December 31, 1976. Under the new rules:

1. No deduction would be allowed for expenses paid or incurred by an individual in attending more than two foreign conventions in any taxable year.

2. With respect to the two conventions for which a deduction is allowable, the amount of expenses that can be deducted for transportation and subsistence are limited. A deduction for transportation expenses outside the United States may not exceed coach or economy rates charged by a commercial airline. The deduction for subsistence may not exceed the dollar per diem rate established for federal employees at the location in which the convention is held.

3. No deduction would be allowed for subsistence expenses unless (a) a full day or half day of business activities are scheduled on each day during the convention, and (b) the individual attends at least two-thirds of the hours of the daily scheduled business activities or, in the aggregate, attends at least two-thirds of the total hours of scheduled business activities at the convention.

4. The taxpayer must comply with additional reporting requirements. He must furnish information indicating the total days of the trip (exclusive of the transportation days to and from the convention), the number of hours of each day that he devoted to business activities (in a brochure describing the convention, if available), and any other information required by regulations. In addition, the taxpayer must attach a statement to his income tax return signed by an appropriate officer of the sponsoring organization which must include a schedule of the business activities of each convention day, the number of hourly-related activities that the taxpayer attended each day and any other information required by regulations.

Issue

The issue is whether a specific exception should be provided to clarify that the new rules for foreign conventions do not apply to "incentive awards" granted by an employer to an employee.

Proposed amendment

The proposed amendment would make it clear that the new rules for allowance of a deduction for attending foreign conventions would not apply to the employer for incentive awards granted by an employer to an employee and similar types of situations where the employee includes an amount of the award in his gross income.

Revenue effect

This amendment would have no effect on budget tax receipts for fiscal years 1978 through 1982.

Departmental position

Although the Treasury Department feels that the issue can be dealt with by regulation, it is not opposed to a rule which would allow an employer a deduction for "incentive awards" which are includible in the gross income of the employee recipient as additional compensation.

5. Technical Modifications to Exchange Fund Provisions (sec. 2131 of the Act, sec. 368 of the Code)

Prior law

Exchange funds are investment entities through which large numbers of investors pool stocks or securities, which usually are highly appreciated, in exchange for shares of the fund in order to diversify their holdings. Under prior law, these funds could be created through partnerships (or through trusts or certain corporate organizations) without payment of tax on the exchange.

1976 Tax Reform Act

The 1976 Act specifically denied tax-free treatment on an exchange or stock for interests in a partnership and on transfers to trusts or in corporate reorganizations in which exchange funds were involved or created.

H.R. 6715

H.R. 6715 provides that, in the case of corporate reorganizations which result in the creation of an exchange fund, losses as well as gains are not to be recognized. This eliminates possible abuses that could arise by creating losses in an exchange without relinquishing control of the loss asset. The bill also makes several minor technical amendments.

Issue

The issue is whether this rule with respect to losses is appropriate.

Proposed amendment

The amendment would strike the provision in H.R. 6715 denying recognition on loss transfers.

Revenue effect

It is estimated that adoption of this amendment will reduce budget receipts by less than $1 million annually.

Departmental position

The Treasury Department recommended and supports the proposed amendment.

6. Automatic Ten-year Adjustment Period For Farming Corporations Required To Use Accrual Accounting (sec 207(c) of the Act, sec. 447 of the Code)

Prior law

Prior to the 1976 Act, any taxpayer engaged in the trade or business of farming was entitled to use the cash method of accounting for such business and to deduct currently costs of a nature which, for other businesses, would be either included in inventory or capitalized.

1976 Tax Reform Act

The 1976 Act generally required that certain farming corporations and certain farming partnerships (in which "nonexcepted" corporations are partners) use the accrual method of accounting and capitalize preproductive period expenses. Exceptions were provided for subchapter S corporations, family corporations, certain small corporations, and taxpayers in the trade or business of operating a nursery.

A transitional rule (sec. 447(f)) provides that a taxpayer who is required by this section to change its method of accounting can, except as otherwise provided in regulations, take the accounting adjustments required by this change into account over a ten-year period. It has been suggested that this transitional rule may be interpreted to provide (1) that a taxpayer who has been in existence fewer than ten years prior to the year of change of accounting method will be permitted to take into account the adjustments only over the number of years it has been in existence and (2) that a taxpayer (such as a partnership) with a stated limited future life will be permitted to take the adjustments into account only over a period which does not exceed its limited future life.

Issue

The issue is whether taxpayers who are required to change to the accrual method of accounting under this provision of the 1976 Act should be allowed to take into account the amount of the accounting adjustments over a full ten-year period if they have been in existence for less than ten years.

Proposed amendment

The proposed amendment would provide that a taxpayer who is required by section 447 to change to the accrual method of accounting, with capitalization of preproductive period expenses, would be able to take the accounting adjustments into account over a ten-year period (except in those situations where a taxpayer had a limited future life of less than ten years).

Revenue effect

It is estimated that enactment of this amendment will result in slight decreases in budget receipts over the first few years of the ten-year period. These amounts, totaling less than $1 million, will be recouped during the later years of the ten-year period.

Departmental position

The Treasury Department is not opposed to the proposed amendment.

7. Automatic Ten-year Adjustment For Farming Syndicates Changing to Accrual Accounting (sec. 207(a) of the Act, sec. 464 of the Code)

Prior law

Prior to the 1976 Act, any taxpayer engaged in the trade or business of farming was entitled to use the cash method of accounting for such business and to deduct currently costs of a nature which, for other businesses, would be either included in inventory or capitalized.

1976 Tax Reform Act

The 1976 Act provided limitations on certain types of deductions for farming syndicates. These limitations generally require farming syndicates (1) to defer deducting the cost of prepaid feed, seed, fertilizer, or other supplies until the supplies are used or consumed, (2) to capitalize or inventory certain preproductive period expenses of poultry, and (3) to capitalize preproductive period expenses of orchards and vineyards.

No transitional rules were provided for farming syndicates affected by this provision. Thus, if a farming syndicate wishes to change to the accrual method of accounting with capitalization of preproductive period expenses, it must, under the ordinary rules, obtain the consent of the Internal Revenue Service, and the Internal Revenue Service would have broad discretion to determine the period (if any) over which it would have to spread the adjustments required by the change in accounting method.

Issue

The issue is whether a farming syndicate which elects to change to the accrual method of accounting with capitalization of preproductive expenses should be eligible to spread adjustments over a 10-year period without IRS approval.

Proposed amendment

The proposed amendment would provide that a farming syndicate which elects to change to the accrual method of accounting and to capitalize preproductive period expenses without prior IRS approval of such a change and would be able to spread the net amount of the adjustments resulting from the change over a period of ten taxable years (unless the stated remaining life of the taxpayer is shorter).

Revenue effect

It is estimated that enactment of this amendment will result in slight decreases in budget receipts over the first few years of the ten-year period. These amounts, totaling less than $1 million, will be recouped during the later years of the ten-year period.

Departmental position

The Treasury Department is not opposed to the proposed amendment.

8. Extending Family Attribution to Spouses in the Farming Syndicate Rules (sec. 207(a) of the Act, sec. 464 of the Code)

Prior law

Prior to the 1976 Act, any taxpayer engaged in the trade or business of farming was entitled to use the cash method of accounting for such business and to deduct currently costs of a nature which, for other businesses, would be either included in inventory or capitalized.

1976 Tax Reform Act

The 1976 Act provided limitations on certain types of deductions for farming syndicates. These limitations generally require farming syndicates (1) to defer deducting the cost of prepaid feed, seed, fertilizer or other supplies until the supplies are used or consumed, (2) to capitalize or inventory certain costs of poultry, and (3) to capitalize preproductive period expenses of orchards and vineyards.

In general, farming syndicates were defined to include (1) any partnership or other noncorporate enterprise engaged in farming if interests in the business were required to be registered with a Federal or State securities agency and (2) any partnership or other noncorporate enterprise engaged in farming if more than 25 percent of the losses during any period are allocable to limited partners or limited entrepreneurs. Generally, limited entrepreneurs and limited partners are individuals who do not actively participate in management of the activity. Certain interests in farming enterprises are not treated as interests held by limited partners or limited entrepreneurs if the interests are attributable to active participation in farm management or certain other qualifications are met by an individual or certain family members of that individual. For purposes of this rule, family members are determined from the grandparent of an individual and members of the grandparent's family. However, under the language of this provision, the individual's spouse and the spouses of other family members other than the grandparent are not included as family members.

Issue

The issue is whether the family member rules of the farming syndicate provisions should cover spouses of members of the family.

Proposed amendment

The proposed amendment would expand the family member rules of the farming syndicate provisions to cover the spouses of family members.

Revenue effect

It is estimated that enactment of this amendment will decrease budget receipts by less than $1 million over the ten-year period.

Departmental position

The Treasury Department supports the proposed amendment.

9. Gain on Sale of Certain Property Transferred in Trust (sec. 701 of the Act, sec. 644 of the Code)

Prior law

Under prior law, capital gains which were accumulated by a trust were taxable to the trust's beneficiaries when the gains were distributed to them under the so-called "capital gain throwback rule".

1976 Tax Reform Act

The 1976 Act repealed the "capital gain throwback rule" and added a new provision (sec. 644) which taxes a trust at the transferor's rate brackets where the trust disposes of an asset within 2 years of its transfer to the trust by the transferor. The statute applies to any gain *realized* by the trust, even if that gain would not be *recognized* by the trust under other provisions of the Code that provide for tax-free treatment in certain situations. Thus, for example, the new provision would apparently apply to stock exchanged in a tax-free reorganization of a corporation if the stock was transferred to a trust not more than 2 years before the reorganization.

In addition, the application of the new provision is unclear where the transferor has items, such as the charitable contributions, net operating losses, capital losses, and investment tax credits, that are carried back or over to the transferor's taxable year in which the property was sold by the trust to another year.

Issue

The issue is whether a trust should be taxed on all gains *realized* by it within 2 years of a transfer to the trust or only those gains that would be *recognized* by the trust under the normal rules providing for tax-free transactions.

Another issue is whether both the trust and the transferor should be able to benefit from certain deductions and credits which are carried over to another year of the transferor.

Proposed amendment

The proposed amendment would provide that a trust would be taxable at the transferor's rates only on gains which are recognized by the trust under the normal rules providing for tax-free transactions.

In addition, the proposed amendment would provide that the tax to the trust would be computed without regard to any items of the transferor that are carried over from that year to a prior or subsequent taxable year of the transferor.

Revenue effect

It is estimated that this amendment would result in an annual decrease of less than $1 million in fiscal year budget tax receipts for fiscal years 1978 through 1982.

Departmental position

The Treasury Department recommended and supports the proposed amendment.

10. Source and Character of Accumulation Distributions from Trusts (sec. 701 of the Act, sec. 667 of the Code)

Prior law

Under prior law, both current and accumulation distributions from trusts were treated as retaining the source and character of the income received by trust from which the distributions were made.

1976 Tax Reform Act

The 1976 Act substantially changed the treatment of distributions of income accumulated by trusts in years prior to the distribution. One of those changes is that distributions of previously accumulated income, other than those attributable to tax-exempt interest, do not retain in the hands of the beneficiary the character or source of the income from which they were distributed. In the case of distributions of previously accumulated income to nonresident aliens and corporate beneficiaries, the elimination of the characterization rules creates problems in connection with the determination of the amount, if any, of U.S. withholding tax to be imposed on the distribution.

Issue

The issue is whether the character and source of income should be retained for distribution of accumulated income by a trust to nonresident aliens and foreign corporations.

Proposed amendment

The amendment would treat distributions by a trust of previously accumulated income to nonresident aliens and foreign corporate beneficiaries as retaining the character and source of the income from which they are distributed.

Revenue effect

It is estimated that this amendment would result in an annual decrease of less than $1 million in fiscal year budget tax receipts for fiscal years 1978 through 1982.

Departmental position

The Treasury Department recommended and supports the proposed amendment.

11. Exempt Interest Dividends of Regulated Investment Companies (sec. 2137 of the Act, sec. 851 of the Code)

Prior law

A regulated investment company (commonly called a mutual fund) is permitted a deduction for dividends paid to its shareholders if it meets several tests. One of the tests is that at least 90 percent of its gross income must be derived from dividends, interest, and gains from the sale or other disposition of stock or securities. Another of the tests is that less than 30 percent of its gross income must be derived from the sale or other disposition of stock or securities held for less than 3 months.

1976 Tax Reform Act

The 1976 Act contained an amendment to the provisions dealing with regulated investment companies which permits a company to pay exempt interest dividends to its shareholders if at least 50 percent of its assets are invested in tax-exempt State and local governmental obligations. However, interest on tax-exempt State and local governmental obligations is not included in gross income. Consequently, a regulated investment company investing all or most of its assets in tax-exempt obligations could fail to meet the 90- and 30-percent tests if it recognizes a relatively small amount of nonqualifying income.

Also, a shareholder may invest in an open end tax-exempt mutual fund shortly before the record date of a future dividend and then tender his share for redemption immediately after the receipt of the tax-exempt interest dividend. Since the fund's assets have been depleted by the amount of the dividend, the shareholder will generally recognize a short-term capital loss on the redemption in the amount of the dividend. The net effect of the two transactions is to create an artificial short-term capital loss which can be used to shelter other capital gains of the shareholder.

Issue

The issue is whether, for purposes of computing the 90- and 30-percent tests, the term "gross income" should include tax-exempt interest from State and local obligations. Another issue is whether the tax laws should permit a shareholder to generate an artificial loss on certain short-term investments in tax-exempt mutual funds.

Proposed amendment

The proposed amendment would provide that "gross income" for purposes of the 90- and 30-percent tests includes tax-exempt interest. In addition, the proposed amendment would disallow any loss recognized within 31 days of the date of purchase on shares in a tax-exempt mutual fund to the extent of any exempt interest dividend received by the shareholder.

Revenue effect

This amendment is not expected to have an effect on budget receipts.

Departmental position

The Treasury Department recommended and supports the proposed amendment.

12. Source of Income on Liquidation of Foreign Corporation (sec. 1034 of the Act, sec. 904(b) of the Code)

Prior law

Generally, the source of income derived from the sale of personal property, including stock, was determined by the place of the sale.

1976 Tax Reform Act

The 1976 Act provided as a general rule that gain on the sale or exchange of personal property outside the U.S. which is not subject to a foreign tax of at least 10 percent will not be considered foreign source income. That general rule does not apply in certain specified situations including, in the case of a sale by a corporation of stock in a second corporation, cases in which the stock is sold in a country in which the second corporation derived more than 50 percent of its gross income. The Act provision was intended to prevent taxpayers from maximizing the use of foreign tax credits by arranging for sales of personal property to take place in low tax foreign countries.

Issue

The issue is whether the special source rule should apply to gains realized by a corporation on the liquidation of a foreign subsidiary even if the subsidiary did not earn more than 50 percent of its income in the country of its incorporation (the country in which the liquidation occurs).

Proposed amendment

The amendment provides that the source of income received by a corporation on the liquidation of a foreign corporation will be treated as foreign source income whether or not the foreign corporation earned more than 50 percent of its income from sources within the country in which it is incorporated.

Revenue effect

It is estimated that enactment of this amendment will decrease budget receipts by less than $5 million annually.

Departmental position

The Treasury Department favors the concept of the proposed amendment but only if it is modified to require the liquidated foreign corporation to have derived more than 50 percent of its gross income from foreign sources for the 3-year period ending with the close of its taxable year immediately preceding the year in which the liquidation occurs.

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13. Recapture of Foreign Losses (sec. 1032 of the Act, sec. 904(f) of the Code)

Prior law

Under prior law, foreign losses generally reduced U.S. tax on U.S. source income by decreasing the worldwide taxable income on which the U.S. tax was based. In addition, when the business operations in the loss country (or countries) became profitable, a credit against U.S. tax was allowed for taxes paid to that country (or countries) without any recapture of the prior benefits from foreign losses (except in the case of foreign oil-related losses, which were subject to recapture).

1976 Tax Reform Act

To reduce these advantages, the 1976 Act extended the recapture provisions to all foreign losses. The Act required that, in cases where a loss from foreign operations reduces U.S. tax on U.S. source income, the loss is to be recaptured by the United States if the company subsequently derives income from abroad. In general, the recapture is accomplished by treating a portion of foreign income which is subsequently derived as income from domestic sources.

The loss recapture provisions apply to losses sustained in taxable years beginning after December 31, 1975. An exception to the effective date is provided for cases where a loss sustained in 1976 is from an investment in a corporation which became substantially worthless prior to the effective date. This exception applies where a corporation has suffered an operating loss in three out of the five years preceding the year in which the loss was sustained, the corporation has sustained an overall loss for those five years, and the termination takes place before January 1, 1977.

An additional exception was provided for cases where an investment is continued beyond 1976 in an attempt to try to make the investment profitable, although the attempt may ultimately fail. The Act provides that if a loss would qualify for the above exception to recapture but for the fact that the investment was not terminated in 1976, and if the investment is terminated before January 1, 1979, there is to be no recapture of the loss to the extent there was on December 31, 1975, a deficit in earnings and profits.

Issue

The issue is whether a modification should be made to the transitional rules with respect to the recapture of losses on investments in corporations which became substantially worthless prior to the effective date and which are disposed of after 1976 but before 1979. Problems in computing the corporation's pre-1976 accumulated deficit in earnings and profits arise where it is necessary to take into account earnings and profits or deficits accumulated prior to the time the U.S. taxpayer owned the stock.

Proposed amendment

The amendment would modify the exception to the recapture rules for substantially worthless investments disposed of after 1976 and before 1979. In computing the December 31, 1975, deficit in earnings and profits, there would only be taken into account earnings or deficits of years after 1962 to the extent that the taxpayer owned the stock of the substantially worthless corporation.

Revenue effect

It is estimated that adoption of this amendment will reduce budget receipts by less than $5 million over the next several years.

Departmental position

The Treasury Department opposes this amendment as a substantive change which is outside the scope of this legislation. Moreover, if the amendment is considered on its merits, the appropriate earnings and profits to be taken into account are post-acquisition earnings without regard to whether the acquisition occurred before or after 1962.

14. Transitional Rule for Loss Recapture Provision (sec. 1032 of the Act)

Prior law

Foreign losses of a taxpayer electing the per country limitation on the foreign tax credit could be used to reduce U.S. tax on U.S. income in the year of the loss. In subsequent years when income is earned in that foreign country, little or no U.S. tax may be obtained because of foreign taxes allowed as credits against that income.

1976 Tax Reform Act

The 1976 Act repealed the per country limitation for years beginning with 1976 and, in addition, provided that any foreign losses on an overall basis are to be recaptured out of future foreign income.

However, the Act provided a three-year exception (i.e., up to 1979) to the repeal of the per country limitation for income from sources within a possession of the United States (including Puerto Rico). No similar exception was provided for the loss recapture rule, but any losses reducing U.S. tax under the per country limitation during the 3-year period are only to be recaptured on a per country basis.

Issue

The issue is whether a 3-year exception is also to be provided for the loss recapture rule for losses arising in the possessions.

Proposed amendment

The amendment would create an exception to the loss recapture rules for losses from the possessions arising in years before 1979.

Revenue effect

It is estimated that the amendment will decrease budget receipts by approximately $3 million in fiscal 1978. The amendment is not likely to have any additional revenue effect until 1980, after which time there is some possibility that it could decrease budget receipts by up to $20 million.

Departmental position

The Treasury Department does not oppose this amendment but recommends that it be modified to provide that the loss recapture rules will not apply to losses from the possessions only where there is an excess of deductions over gross income from sources in a possession within an affiliated group (as defined in Code section 1504(a) without the exclusion of corporations described in section 1504(b)(3) and (4)).

15. Foreign Tax Credit for Production-sharing Contracts (sec. 1035(c) of the Act)

Prior law

An IRS Revenue Ruling (Rev. Rul. 76–215) holds that a contractor operating under a production-sharing contract in Indonesia is not entitled to a foreign tax credit for payments made by the government-owned company to Indonesia which contractually satisfy the contractor's tax liability. The IRS announced that this ruling would only apply prospectively to credits claimed for taxes paid in taxable years beginning on or after June 30, 1976.

Apparently the Indonesian taxes affected by the ruling are imposed annually on a calendar year basis, and the entire annual tax liability accrues on December 31 with respect to each year. Consequently, the ruling did not affect the credibility of Indonesian taxes paid and accrued with respect to 1976 by calendar year taxpayers and taxpayers whose fiscal year began before June 30, 1976. With respect to taxpayers whose fiscal year began on or after June 30, the ruling applied to the fiscal year beginning in 1976 and ending in 1977, and therefore disallowed the creditability of Indonesian taxes imposed with respect to 1976.

1976 Tax Reform Act

The 1976 Act provides that Revenue Ruling 76–215 is not to apply to most taxpayers for taxable years ending in 1977 to amounts paid to foreign governments and designated as taxes under production-sharing contracts entered into before April 8, 1976. The 1976 Act generally intended to delay the effect of the ruling for one year so that the companies would have additional time to renegotiate their production-sharing contracts with Indonesia. The Act does result in a one-year delay in the effective date of the ruling for taxpayers on a calendar year basis (for taxes paid with respect to 1977) and for taxpayers with fiscal years ending on or after June 30, (for Indonesian taxes paid with respect to 1976). In the case of taxpayers with fiscal years ending before June 30, the Act does not delay the effective date of the ruling.

Issue

The first issue presented is whether the additional one year extension provided by the 1976 Act should be extended to all taxpayers (so that the ruling does not apply to the 1977 Indonesian taxes paid by taxpayers with fiscal years ending before June 30). The second issue is whether a further one-year delay should be provided for taxpayers with fiscal years ending on or after June 30 so that the ruling does not apply to Indonesian taxes paid by any taxpayers with respect to 1977.

Proposed amendment

The amendment would delay the effect of the revenue ruling until 1978 for all taxpayers (so that taxes paid by all taxpayers in 1977 would be creditable).

Revenue effect

It is estimated that enactment of this amendment will reduce budget receipts by approximately $5 million in fiscal year 1978 only.

Departmental position

The Treasury Department does not oppose this amendment.

16. Recapture of Accumulated DISC Income in Section 337 Liquidations (sec. 1104(g)(4) of the Act, sec. 994(c) of the Code)

Prior law

Upon the sale of the stock in a DISC, the accumulated deferred income of the DISC is recaptured and taxed to the selling shareholder. Under prior law, recapture of the accumulated DISC income could be permanently avoided by selling or distributing the DISC stock in certain tax-free transactions (under secs. 311, 336 or 337).

1976 Tax Reform Act

The 1976 Act provided for recapture of the accumulated DISC income on sales or distributions of DISC stock in tax-free transactions under sec. 311, 336 or 337 which occur after December 31, 1975 (the general effective date of the DISC provisions).

Issue

This recapture provision was not contained in the House bill but was added to the Act as part of the DISC provisions of the Senate amendment, which generally were effective for sales after December 31, 1976. The conference committee adopted the substantive provisions of the Senate bill, but with the December 31, 1975, effective date of the House bill. The use of the House bill's December 31, 1975, effective date results in the application of the Senate's recapture rule to transactions occurring during 1976 when the taxpayers did not have notice that the recapture provision would apply.

Proposed amendment

The amendment would delay the effective date of the DISC recapture provision until December 31, 1976.

Revenue effect

It is estimated that adoption of this amendment will reduce budget receipts by less than $1 million in fiscal year 1978.

Departmental position

The Treasury Department opposes this amendment as a substantive change.

17. Excise Tax on Transfers by Estates to Foreign Entities (sec. 1491 of the Code, sec. 1015 of the Act)

Prior law

An excise tax (sec. 1491) is imposed upon the transfer of certain appreciated property to foreign entities. The tax applies to citizens or residents of the United States and to domestic corporations, partnerships, and trusts. Under prior law, it did not apply for estates because the basis of assets transferred at death was "stepped-up" to their fair market value on the date of death (or alternative valuation date where applicable).

1976 Tax Reform Act

The 1976 Act increased the excise tax and expanded application of the tax to additional types of property. In addition, the Act provided for a carryover basis of assets transferred at death. Since assets transferred by estates do not generally receive a step-up in basis, assets transferred by estates to foreign entities can escape both the U.S. capital gains and excise taxes.

Issue

The issue is whether the excise tax should be extended to estates.

Proposed amendment

The amendment would extend the excise tax on transfers of property to foreign entities to transfers made by estates subject to U.S. tax. In addition, it would extend the tax to transfers of appreciated property by U.S. persons to foreign estates.

Revenue effect

It is estimated that enactment of this amendment will increase budget receipts by less than $1 million annually.

Departmental position

The Treasury Department recommended and supports the proposed amendment.

18. Holding Period of Commodity Futures Contracts (sec. 1222 of the Code, sec. 1402 of the Act)

Prior law

Under prior law, assets were required to be held for 6 months or longer to be eligible for long-term capital gain treatment.

1976 Tax Reform Act

The 1976 Act increased the holding period for long-term capital gains to 9 months for 1977 and to 12 months for subsequent years. An exception was provided for commodities futures contracts, which continue to be eligible for the 6-month holding period.

The increase in the holding period to 9 and 12 months was a provision included in the House bill but not in the Senate version of the Act. The language of the House bill provided the exception for "future transactions in any commodity" although the legislative history clearly states that what was intended was "future transactions in any agricultural commodity." The omission of the word "agricultural" from the House bill could not have been corrected by the conference committee because the change was technically beyond the scope of the conference. Thus, the bill as enacted provides for a continuation of the six-month holding period for all commodities futures contracts.

Issue

The issue is whether the 6-month holding period exception should apply to all commodity future contracts or apply only to agricultural commodities future contracts.

Proposed amendment

The amendment would limit the application of this 6-month holding period exception to agricultural commodities futures contracts.

Revenue effect

It is estimated that this amendment would result in an annual increase in fiscal year budget tax receipts of $5 million for 1978 and $8 million each fiscal year thereafter.

Departmental position

The Treasury Department supports the proposed amendment since it carries out the intent of Congress to limit the exception to the increase of holding period rules to agricultural commodities futures contracts.

19. Treatment of Grantor Trusts as Subchapter S Corporation Shareholders (sec. 1371 of the Code, sec. 902 of the Act)

Prior law

A corporation could not elect subchapter S corporation treatment if any of its shareholders were a trust.

1976 Tax Reform Act

The Act permits a so-called "grantor trust" (i.e., a trust whose income is taxed currently to the grantor) to be a shareholder of a subchapter S corporation. In addition, testamentary trusts are permitted to be shareholders for a period of up to 60 days. However, grantor trusts which are often used as will substitutes are not eligible shareholders for any period of time after the grantor's death.

H.R. 6715

H.R. 6715 permits grantor trusts like testamentary trusts to be eligible shareholders for the 60-day period.

Issue

The issue is whether grantor trusts should be allowed to continue as eligible shareholders for a limited period after the grantor's death.

Proposed amendment

The amendment would permit grantor trusts to remain eligible shareholders for 2 years after the death of the grantor in cases where the assets of the trusts are included in the grantor's gross estate. (The 2-year period is considered to be roughly equivalent to the estate and trust period with respect to testamentary trusts, i.e., a normal period of administration while the stock is held by the estate and a 60-day period after the testamentary trust receives the stock from the estate.)

Revenue effect

It is estimated that this amendment would result in an annual decrease in fiscal year budget tax receipts of less than $1 million for fiscal years 1978 through 1982.

Departmental position

The Treasury Department recommended and supports the proposed amendment.

20. Disclosure of Taxpayer Addresses to NIOSH (sec. 6103 of the Code, sec. 1202 of the Act)

Prior law

Under prior law, the National Institute of Occupational Safety and Health (NIOSH) could, pursuant to Treasury regulations, obtain from the IRS the addresses of taxpayers. NIOSH used this information for the purpose of locating persons previously employed in occupations in which they were, or may have been, exposed to known or suspected, hazardous substances.

1976 Tax Reform Act

The 1976 Act treats taxpayer return information, including the address supplied by the taxpayer on his or her income tax return, as confidential information not subject to disclosure by the IRS, except as specified in the Act. While the Act provides for disclosure of address information in certain situations, no provision was made in the Act for disclosure of that information to NIOSH for any purpose.

Issue

The issue is whether NIOSH should be authorized to obtain from the IRS taxpayer address information.

Proposed amendment

The amendment provides that taxpayer return information can be disclosed to NIOSH for purposes of locating persons possibly exposed to hazardous substances.

Revenue effect

This amendment would have no effect on budget tax receipts.

Departmental position

The Treasury Department does not oppose the proposed amendment.

21. Disclosure of Mailing Address of Individuals Who Have Defaulted on Student Loans (sec. 6103 of the Code, sec. 1202 of the Act)

Prior law

Under prior law, returns and return information were made available to a number of Federal agencies on the written request of the head of the agency in connection with matters within the jurisdiction of the agency. However, prior law did not authorize an agency to make a further disclosure of the return or return information to any other party, such as an educational institution. Such a disclosure was not only unauthorized, but subject to criminal penalty.

1976 Tax Reform Act

The 1976 Act provided that, as a general rule, returns and return information are to be confidential and not subject to disclosure except as specifically provided in the Code. Exceptions are made to allow the disclosure of returns and return information to several Federal agencies for specified purposes. However, no exception was provided to permit disclosure to the Commissioner of Education of the mailing address of any person who has defaulted on a student loan.

Issue

The first issue is whether the IRS should be given the authority to disclose the address of a taxpayer to the Commissioner of Education in order for the Commissioner to locate persons who have defaulted on a student loan.

The second issue is whether this information should be disclosed to educational institutions.

Proposed amendment

The amendment would allow the disclosure of a taxpayer's address to the Commissioner of Education for purposes of locating the taxpayer where he had defaulted on a student loan.

This information could also be disclosed to educational institutions for the same purpose.

Revenue effect

This amendment would have no effect on budget tax receipts.

Departmental position

The Treasury Department does not oppose disclosure of a taxpayer's address to an agency of the Government to assist in the collection of an obligation owed to the United States. However, it is opposed to the disclosure of this information to educational institutions or private individuals.

22. Disclosure of Tax Return Information Regarding Special Fuel Excise Taxes (sec. 6103(d) of the Code, sec. 1202 of the Act)

Prior law

Under prior law, special fuel exercise tax information was exchanged between the IRS and State tax officials. The exchange dealt with tax return and audit information on diesel fuel, special motor fuel, and noncommercial aviation fuel purchases and was designed to induce greater compliance with related Federal and State taxes.

1976 Tax Reform Act

The 1976 Act significantly increased the confidentiality of tax returns and tax information by substantially restricting the instances in which returns or return information may be disclosed to those agencies and individuals enumerated in section 6103 of the Code. The Act provided that returns and return information relating to specified Federal taxes could generally be disclosed to State tax officials for the purpose of, but only to the extent necessary in, the administration of State tax laws. However, the Act omitted taxes imposed by chapter 31 of the Code (i.e., the special fuel excise taxes) in the list of taxes with respect to which information could be disclosed to State tax officials. As a result, the IRS no longer has the authority to provide State tax officials with returns or return information regarding special fuel excise taxes.

Issue

The issue is whether disclosure of returns and return information regarding special fuel excise taxes should be permitted by the IRS to State tax officials.

Proposed amendment

The proposed amendment would include return information regarding the special fuel excise taxes among the information which the IRS is authorized to disclose to State tax officials.

Revenue effect

This amendment would have no effect on budget tax receipts.

Departmental position

The Treasury Department supports the proposed amendment.

23. Negotiation of Taxpayer Refund Check by Banks (sec. 6695 of the Code, sec. 1203 of the Act)

Prior law

Under prior law, there were no limitations on the endorsement of refund checks of taxpayers.

1976 Tax Reform Act

The 1976 Act prohibited any tax return preparer from endorsing a refund check of any individual whose return he prepared (except for subsequent endorsements by banks). A $500 fine was provided for violation of this provision.

Many banks prepare returns of individual in their capacity as a guardian, conservator, or other fiduciary with respect to the individual. Under the 1976 Act in this case, the bank could not deposit a refund check to the taxpayer without first obtaining the taxpayer's endorsement. The Act does not provide an exception for banks who are tax return preparers for their customers generally (i.e., in other than a fiduciary corporation).

H.R. 6715

H.R. 6715 provides that banks which prepare a return as a fiduciary of an individual may directly endorse that individual's refund check without violating the 1976 Act prohibition. Under this rule, unless the fiduciary relationship exists, a bank cannot directly endorse and deposit a customer's refund check to the account without a prior endorsement by the customer.

Issue

The issue is whether a bank should be permitted to endorse and deposit a customer's tax refund check in any case where the customer's tax return was prepared by that bank.

Proposed amendment

The proposed amendment would permit a bank to endorse and deposit a customer's tax refund check in any case where the customer's tax return was prepared by that bank.

Revenue effect

This amendment would have no effect on budget tax receipts.

Departmental position

The Treasury Department does not oppose the proposed amendment. A similar rule is already under active consideration in connection with the final regulations to be issued under the tax return preparer provisions to which this amendment relates.

24. Criminal Penalty for Unauthorized Disclosures of Tax Return Information (sec. 7213 of the Code, sec. 1202(d) of the Act)

Prior law

Under prior law, unauthorized disclosure of a Federal income tax return or financial information appearing thereon by a Federal or State employee was a misdemeanor punishable by a fine of up to $1,000, or imprisonment of up to one year, or both. It was also a misdemeanor punishable in the same manner for any person to print or publish an income tax return or any financial information appearing in an income tax return.

1976 Tax Reform Act

Under the 1976 Act, the criminal violation of the disclosure rules is a felony punishable by a fine of up to $5,000, or imprisonment of up to 5 years, or both. It is also a felony, subject to the same penalties, for any person willfully to receive returns or return information as a result of an offer by that person to exchange an item of material value for the unauthorized disclosure.

As a general rule, in order for a violation of a statute to constitute a crime, the individual must have had a criminal intent. However, the Code does not explicitly limit the criminal penalties for unauthorized disclosures which are willful.

Issue

The issue is whether the statute should be made explicit that the criminal penalties for unauthorized disclosures only apply to willful disclosures.

Proposed amendment

The amendment would clarify the disclosure provisions by limiting the criminal penalties to situations where the unauthorized disclosures are willful.

Revenue effect

This amendment would have no effect on budget tax receipts.

Departmental position

The Treasury Department supports the proposed amendment.

25. Civil Penalties for Unauthorized Disclosures (sec. 7217 of the Code, sec. 1202(e) of the Act)

Prior law

Under prior law, there was no provision providing for a civil remedy to permit taxpayers to sue for damages in the event of an unauthorized disclosure of their returns or return information.

Tax Reform Act of 1976

The 1976 Act provided that any person who willfully or negligently discloses returns or return information in violation of the law is liable to any taxpayer for actual damages sustained plus court costs (but in no event less than $1,000 liquidated damages with respect to each unauthorized disclosure).

The Joint Committee staff's General Explanation of the Act states that "Congress does not intend that a disclosure of returns or return information made pursuant to good faith, but erroneous, interpretation of the confidentiality rules would constitute an action disclosure." Since, however, that limitation is not set forth in the statute, there is some concern that it would not be binding in a court case.

Issue

The issue is whether the statute should clearly exclude from the civil penalty rules those disclosures made pursuant to a good faith, but erroneous, interpretation of the confidentiality rules.

Proposed amendment

The proposed amendment would provide in the Code that no civil liability would be imposed as a result of a disclosure made as the result of a "good faith, but erroneous, interpretation of the disclosure rules."

Revenue effect

This amendment would have no effect on budget tax receipts.

Departmental position

The Treasury Department supports the proposed amendment.

26. Declaratory Judgments—Revocation of Prior Law (secs. 7428 and 7476 of the Code, sec. 1306 of the Act)

Prior law

In the 1974 pension Act (ERISA), Congress provided for declaratory judgments "in a case of actual controversy involving—(1) a determination by the Secretary with respect to the initial qualification *or continuing qualification* of a retirement plan * * * ." (Emphasis supplied.)

1976 Tax Reform Act

The 1976 Act provided for declaratory judgments "in a case of an actual controversy involving—(1) a determination by the Secretary—(A) with respect to the initial qualification *or continuing qualification of* an organization as an organization described in section 501(c)(3) * * * ." (Emphasis supplied.) Both the House and Senate committee reports on the 1976 Act stated that this statutory language, in both Acts, is intended to grant jurisdiction in cases where the Internal Revenue Service has concluded that a previously qualified organization has lost its preferred tax status.

On October 6, 1976, the Tax Court published an opinion (*Sheppard & Myers Inc. v. Comm'r*, 67 T.C. 26) in which it held that the retirement plans declaratory judgment provisions do not apply to revocations of favorable determination letters. The Tax Court decision made no mention of the 1976 Act or of the committee reports on that Act.

Issue

The issue is whether the declaratory judgment provisions should be modified to clearly indicate the Congress' intent that they apply to revocations of prior favorable determinations.

Proposed amendment

The proposed amendment would clarify the Congress' intent that the declaratory judgment provisions apply to revocations of prior favorable determinations.

Revenue effect

This amendment would have no effect on budget tax receipts.

Departmental position

The Treasury Department supports the proposed amendment. Interested parties should have the same forum to contest an adverse determination by the Internal Revenue Service resulting from the operation of a plan or organization as is available when the plan or organization is instituted.

B. TECHNICAL AND CONFORMING AMENDMENTS TO THE ESTATE AND GIFT TAX PROVISIONS

27. Extension of Section 303 to Income Taxes Attributable to Qualified Redemptions (sec. 303 of the Code, sec. 2005 of the Act)

Prior law

Under prior law, the cost or other basis of property acquired from or passing from a decedent generally was "stepped-up" to its fair market value at the date of death (or the alternative valuation date). In addition, in certain cases under both prior and present law, a distribution in redemption of stock of a closely held corporation to pay death taxes, which would otherwise be treated as a dividend distribution, is treated as an amount realized from the sale or exchange of a capital asset rather than as dividend income (sec. 303). However, this provision is limited to an amount necessary to pay estate taxes and administrative expenses. It is not available for amounts necessary to pay any income taxes of the estate.

1976 Tax Reform Act

The Act provides that the basis of most property acquired from or passing from a decedent who dies after December 31, 1976, is to be the same as the decedent's basis immediately before his death (with certain adjustments). Even with these adjustments, there is likely to be some gain which will be subject to income tax upon the redemption of the stock of a closely held corporation. If additional stock of the corporation is redeemed to pay the income taxes attributable to the redemption to pay death taxes, the gain will generally not be capital gain.

Issue

The issue is whether capital gain treatment should be extended to redemptions of stock to pay income taxes resulting from a qualified redemption to pay estate taxes and administration expenses.

Proposed amendment

The proposed amendment would extend capital gain treatment to redemptions to pay income taxes resulting from a qualified redemption to pay estate taxes.

Revenue effect

It is estimated that this amendment would result in a decrease in fiscal year budget tax receipts of less than $1 million in fiscal year 1978, of $2 million in fiscal year 1979, of $3 million in fiscal year 1980, of $4 million in fiscal year 1981, and of $5 million in fiscal year 1982.

Departmental position

The Treasury Department opposes the proposed amendment.

28. Relationship of Section 303 to Section 306 Stock (Secs. 303 and 306 of the Code, Sec. 2005 of the Act)

Prior law

Under present law, special rules are provided to prevent the "bail-out" of dividends as capital gains upon a sale or redemption of preferred stock distributed to shareholders (sec. 306). Under these rules, the amount realized from a sale or redemption of certain preferred stock, known as "section 306 stock" is treated as dividend income. Under prior law, the dividend income treatment of the stock was eliminated (i.e., the section 306 "taint" was removed) when it passed from a decedent since the basis of the stock was not determined in whole or in part by reference to the decedent's basis (i.e., the basis was "stepped-up" to fair market value at death).

In addition, in certain cases under present law, a distribution in redemption of stock of a closely held corporation to pay death taxes and administration expenses is treated as an amount realized from the sale of exchange of a capital asset rather than as dividend income (sec. 303). Since, under prior law, the dividend treatment of "section 306 stock" was eliminated at the death of the shareholder, it was clear under prior law that redemptions after death of stock which was "section 306 stock" qualified for capital gain treatment if the other requirements of section 303 were met.

1976 Tax Reform Act

Under the carryover basis provisions added by the 1976 Act, the dividend income treatment of "section 306 stock" is continued after the death of the shareholder. As a result, it is presently unclear whether the provision extending capital gains treatment for redemptions to pay death taxes (sec. 303) overrides the preferred stock bail-out provision (sec. 306) in the case where section 306 stock is redeemed from the estate or heirs to pay estate taxes.

H.R. 6715

The bill would make it clear that capital gains treatment under the redemption provision is not generally available for section 306 stock.

Issue

The issue is whether the redemption of "section 306 stock" should be treated as a sale or exchange subject to capital gain treatment where the proceeds from the redemption are used to pay death taxes, administration expenses, and the requirements of section 303 are met.

Proposed amendment

The proposed amendment would provide that capital gain treatment would apply to the redemption of "section 306 stock" if the requirements of section 303 are met.

Revenue effect

It is estimate that this amendment will result in a decrease in fiscal year budget tax receipts of less than $1 million in fiscal year 1978, of $1 million in fiscal year 1979, of $2 million in fiscal year 1980, of $3 million in fiscal year 1981, and of $4 million in fiscal year 1982.

Departmental position

The Treasury Department recommended and supports the proposed amendment.

29. Amendment of Governing Instruments To Meet Requirements for Gifts of Split Interest to Charity (sec. 2522 of the Code, sec. 1304 of the Act)

Prior law

The Tax Reform Act of 1969 imposed new requirements that must be met in order for a charitable deduction to be allowed for income, gift, and estate tax purposes for the transfer of a split interest to charity (i.e., part charitable and part non-charitable). In the case of a remainder interest in trust, the interest passing to charity must be in either a charitable remainder annuity trust, a charitable remainder unitrust, or a pooled income fund. In the case of an "income" interest passing to charity (i.e., a charitable lead trust), the "income" interest must be either a guaranteed annuity or a fixed percentage of the fair market value of the trust (determined at least annually).

Many persons have created instruments that do not comply with these new requirements. As a result, Congress provided, as early as 1974, that the governing instruments of trusts could be amended to meet the new rules within certain time limitations. However, it provided this relief only in the case of the charitable deduction for estate tax purposes and only for remainder interests passing to charity. No relief was provided for the charitable deduction for income or gift tax purposes or for "income" interests passing to charity for income, gift or estate tax purposes.

1976 Tax Reform Act

The 1976 Act extended the period until December 31, 1977, during which amendments of trusts are permitted in order to qualify the trust for the charitable estate tax deduction as a charitable remainder trust.

Issue

The issue is whether relief similar to that permitted for remainder interests passing to charity for estate tax purposes should also be extended to lifetime transfers of both income and remainder interests to charity for income and gift tax purposes.

Proposed amendment

The proposed amendment would permit amendment of charitable remainder trusts to be effective for purposes of both the income and gift tax charitable deductions if the amendment is made (or judicial proceedings are begun) by December 31, 1977.

Another proposed amendment would permit amendment of a charitable "income" trust or to a charitable remainder trust to be effective for purposes of the charitable gift tax deduction if the amendment is made (or judicial proceedings are begun) by December 31, 1977.

Revenue effect

It is estimated that the amendment granting both income tax and gift tax deductions for charitable remainder trusts would result in a decrease in fiscal year budget tax receipts of $4 million in fiscal year 1978 and a negligible decrease thereafter.

It is estimated that the amendment granting a gift tax deduction both for charitable "income" and remainder trusts would result in a decrease of fiscal year budget tax receipts of $4 million in fiscal year 1978 and will have no effect on budget tax receipts thereafter.

Departmental position

The Treasury Department does not oppose the proposed amendment.

30. Exemption From Generation-Skipping Tax for Power To Allocate Among Charitable Beneficiaries (sec. 2613 of the Code, sec. 2006 of the Act)

Prior law

Under prior law, it was possible to avoid imposition of the estate tax in certain so-called "generation-skipping transfers".

1976 Tax Reform Act

The 1976 Act imposes a tax in the case of generation-skipping transfers under a trust or similar arrangement upon the distribution of the trust assets to a generation-skipping heir (for example, a distribution to a great-grandchild of the grantor) or upon the termination of an interest of an intermediate generation in the trust (for example, the termination of an interest held by the transferor's grandchild). The tax will be substantially equivalent to the estate tax which would have been imposed if the property had been actually transferred outright to each successive generation.

The generation-skipping tax is not imposed by reason of the death of a member of an older generation if the decedent was not treated as a beneficiary because he had (1) nothing more than a right of management over the trust assets or (2) a limited power to appoint the trust assets among the lineal descendants of the grantor. However, the power to allocate corpus or income among charitable beneficiaries which is held by a member of an older generation will cause that member to be a beneficiary for generation-skipping tax purposes.

Issue

The issue is whether a person should be considered a "beneficiary" of a trust (for purposes of the tax on generation-skipping transfers) where his sole power is to allocate income or corpus among charitable beneficiaries.

Proposed amendment

The proposed amendment would provide that a "power" in a generation-skipping trust does not include the power to allocate corpus or income among charitable beneficiaries so long as the corpus or income is irrevocably committed for charitable purposes.

Revenue effect

The revenue effect of this amendment cannot be estimated due to the lack of information relating to the particular type of trusts involved.

Departmental position

The Treasury Department opposes the proposed amendment.

31. Reliance by an Executor on Information Furnished by the IRS Concerning the Decedent's Taxable Gifts Made After 1976 (sec. 6018 of the Code)

Prior law

Under prior law, the estate tax generally was determined independently of the gift tax, and was not dependent upon the gifts made by the decedent during his life. However, under prior and present law, an executor can obtain copies of any tax returns of the decedent.

1976 Tax Reform Act

The 1976 Act imposed a single unified progressive rate schedule on the basis of the cumulative lifetime and deathtime transfers. Under this system, the estate tax is dependent upon the lifetime transfers of the decedent. In addition, an executor must file an estate tax return where the gross estate exceeds $120,000 (increasing to $175,000 by 1981) reduced by the taxable gifts made after 1976.

Issue

The issue is whether the executor should be relieved from personal liability attributable to the amount used as cumulative lifetime transfers if he has relied in good faith on information furnished by the IRS.

Proposed amendment

The proposed amendment would relieve the executor from liability if he relied upon information furnished by the IRS concerning the taxable gifts made by the decedent after 1976 (except with respect to gifts made within 3 years of death).

Revenue effect

This amendment would have no effect on budget tax receipts.

Departmental position

The Treasury Department supports the proposed amendment. However, the Department believes that relief from personal liability should be limited to deficiencies attributable to good faith reliance upon gift tax returns for gifts made more than three years before the death of the decedent.

32. Public Index of Filed Tax Liens (sec. 6323 of the Code, sec. 2008 of the Act)

Prior law

Under prior law, a Federal tax lien takes priority (with certain relatively limited exceptions) over interests in the property subject to the lien which are held by purchasers, holders of a security interest, mechanic's lienors and judgment lien creditors if notice of the tax lien has been appropriately filed before such interests are acquired.

1976 Tax Reform Act

The 1976 Act provides that a notice of a lien is not to be treated as meeting the filing requirements unless a public index of the lien is maintained at the district Internal Revenue Service office in which the property subject to the lien is situated. For this purpose, an index of liens affecting real property would be maintained in the district office for the area in which the real property is physically located. In the case of liens affecting personal property, the index would be maintained in the district office for the area in which the residence of the taxpayer is located at the time the notice of lien is filed.

Issue

The issue is whether an indexing requirement should apply under applicable local law with respect to indexing by the state or local office where notices of tax liens are filed rather than having the Internal Revenue Service maintain an index.

Proposed amendment

The proposed amendment would eliminate the IRS indexing requirement and replace it with a new indexing requirement only in the case of real property. The new indexing requirement would apply if the following two conditions are met. First, State law must require public indexing of a deed to be valid against a purchaser of the property who does not have actual notice or knowledge. Second, the appropriate office where notices of tax liens are filed must have an adequate system for indexing of Federal tax liens.

Where these two conditions are satisfied, the priority of a tax lien against purchasers and other creditors will be determined by reference to the time of indexing rather than the time of filing of the notice of tax lien. Purchasers and creditors, who acquire their interests in the property subject to a tax lien before the notice of tax lien has been indexed, will be protected against a previously filed lien.

Revenue effect

This amendment would have no effect on budget tax receipts.

Departmental position

The Treasury Department recommended and supports the proposed amendment.

C. CLERICAL CORRECTIONS AND CROSS-REFERENCE CHANGES

33. Cross-reference and Obsolete Provisions (Various secs. of the Code)

1976 Tax Reform Act

Title XIX of the 1976 Act, known as the Deadwood provision, repealed numerous obsolete provisions of the Code. The staff has discovered several omissions and incorrect cross-references which should be corrected. These include: (1) a cross-reference to section 804(a)(4) in Code section 1561(b)(3); (2) a reference in 1033(a)(2) to section 1033(c); (3) redesignation of section 311(d)(2)(H) as 311(d)(2)(G); (4) an incorrect reference in section 1375(a)(2); (5) an obsolete provision in section 172(b)(3)(A) and corresponding conforming changes: (6) an omission in section 443(b) relating to the definition of "taxable income"; and (7) an incorrect reference in subsections (d) and (k) of section 48.

Proposed amendment

The proposed amendment would make technical corrections to these provisions.

Revenue effect

This amendment would have no effect on budget tax receipts.

Departmental position

The Treasury Department has no objection to the proposed amendment.

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