[COMMITTEE PRINT]

SUMMARY OF SENATE SUBSTITUTE AMENDMENT TO H.R. 421

PREPARED FOR THE USE OF

THE HOUSE AND SENATE CONFEREES ON H.R. 421

BY THE STAFF OF THE

JOINT COMMITTEE ON INTERNAL REVENUE TAXATION

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SUMMARY OF SENATE SUBSTITUTE AMENDMENT TO H.R. 421

The House-passed bill amended the tariff schedules of the United States to make duty-free imports of upholstery regulators, upholsterer's regulating needles and upholsterers' pins. The Senate bill is a substitute for the provisions of the House bill. It is one amendment the provisions of which are as follows:

Sec. 1. Amendment of Tariff Schedules (p. 1)

This provision is identical to the House-passed bill relating to the duty-free importation of upholstery regulators and upholsterers' regulated needles and pins.

Sec. 2. Clerical (reference to Internal Revenue Code of 1954) (p. 2)

Sec. 3. One-year Extension of Amortization Provisions (p. 3)

The Senate provision extends for one additional year through December 31, 1975, four 5-year amortization provisions. These four provisions are: (1) rehabilitation of low and moderate income housing; (2) pollution control facilities; (3) railroad rolling stock; and (4) certain coal mine safety equipment. (This provision was added by the Finance Committee and is identical to section 231 of H.R. 17488.[1])

Sec. 4. Accrual of Vacation Pay (p. 4)

The Senate provision represents a permanent solution for the treatment of accrued vacation pay. The Congress has been continuing the temporary treatment in this area pending a permanent solution. The last extension expired in 1973 and a permanent solution is provided by the Senate amendment. This treatment allows an employer to take a deduction in the case of accrued vacation pay which, except for contingencies (such as termination of employment before vacation time arrives), has already been earned by the employees. However, to prevent a doubling up of deductions in the case of an employer who is newly going on to the accrual pay system, this provision of the bill provides that the employer may not currently take a deduction for contingent amounts which accrued in years prior to the year in which he elected this treatment. This amount is held in suspense and is available as a deduction in subsequent years only to the extent that the end of the year liability for accrued vacation pay (on the new basis) is less than the beginning amount held in the suspense account. (This provision was added by the Finance Committee and is identical to section 241 of H.R. 17488.)

[1] H.R. 17488 is the Energy Tax and Individual Relief Act of 1974.

Sec. 5. Application of Class Life System to Real Property and Extension of Real Estate Depreciation Recapture Rules on Federally, State and Locally-Assisted Housing Projects (pp. 9–10)

(1) This Senate action repeals the provision of present law (Revenue Act of 1971) requiring the application of the class life system to real property. Present law provides that after 1973 the class life system (sometimes referred to as the asset depreciation range or ADR provision) is to apply to real estate. The Treasury has not as yet devised a satisfactory class life system of real estate. The Senate action provides that the ADR system is not to apply to real estate until such time as the Treasury Department develops regulations on a class life system for real estate. (This provision was added by the Finance Committee and is the same as section 251 of H.R. 17488.)

(2) This Senate provision deals with an extension of the real estate recapture rules on certain housing projects. The effect of the recapture rules are to tax the gain from such sales as ordinary income (rather than capital gain) to the extent of the deductions taken under accelerated depreciation in excess of straight-line depreciation. In the case of Federal, State, and locally assisted housing projects (which are limited as to the rate of return on the investment, such as the FHA 221(d)(3) and the FHA 236 programs) where the construction or acquisition occurs before January 1, 1975, there is full recapture during the first 20 months of holding and this is decreased by one percent a month thereafter (with no recapture at the end of 10 years). In the case of most housing, there is full recapture during the first 100 months after which there is a decrease of the amount recaptured by one percent a month (with no recapture after 16⅔ years). These general recapture rules apply to the governmentally assisted housing in the case of construction and acquisitions in 1975 and later years. The Senate provision extends for one more year, until January 1, 1976, the shorter recapture period for the governmentally assisted housing projects. (This was a Senate floor amendment sponsored by Senator Javits.)

Sec. 6. Real Estate Investment Trusts: Treatment of Foreclosure Property and Property Held for Sale to Customers (p. 10)

The Senate provision deals with some of the tax problems of real estate investment trusts. Under present law, a real estate investment trust (REIT), if it derives most of its income from real estate investments (and meets certain other requirements), is not taxed on its distributed income but instead is allowed "pass through" tax treatment whereby the income is taxed to the shareholders and not the trust. A series of revisions had been proposed for the revision of the tax treatment of real estate investment trusts to take account of current practices and economic problems faced by the industry. The Senate provision deals only with the most pressing current problems of the industry, those relating to the tax treatment of foreclosure property. The Senate provision, in general, provides that a REIT is not to be denied the "pass through" treatment because of income it receives from foreclosure property which before the foreclosure was qualified real estate income. In general, under the Senate provision the REIT will be taxed as a corporation on the income from the foreclosure property and will have a period of time to sell the foreclosure property or convert it into qualified property.

The Senate amendment also takes into account the difficulty a REIT faces as a result of the provision of present law prohibiting it from holding any property for sale to customers. In this regard, the Senate provision modifies the rule to a limited extent to allow a REIT to hold foreclosure property for sale. (This provision was added by the Finance Committee and is essentially the same as a limited portion of the REIT provisions of H.R. 17488 (sec. 263).)

Sec. 7. Increase in Interest Charged and Paid in Connection with Deficiencies (p. 16)

The provision increases the interest rate paid by taxpayers on tax deficiencies, and by the government on tax overpayments, from 6 percent to 9 percent per year effective for obligations outstanding on July 1, 1975. In addition to updating the tax interest at this time, the provision provides a procedure whereby the interest rate in the future will be kept up to date with changes in the money market rates. It provides that the tax interest rate is to be adjusted as the prime rate quoted by commercial banks to large business changes. The government interest rate is to be 90 percent of this prime rate but to be at the nearest whole interest rate and not to be changed more than once every two years. (This provision was added by the Finance Committee. The part of the provision increasing the interest rate to 9 percent is the same as section 281 of H.R. 17488.)

Sec. 8. Interest on Certain Obligations (p. 20)

The provision deals with the tax treatment of student loan funding programs. Present law exempts interest paid on most State and local governmental obligations from Federal income tax. The provision adds a new category to the list of obligations, the interest from which is exempt from Federal income tax. The category added is qualified scholarship funding bonds where the student loan programs are financed by nonprofit higher education authorities which are requested by governmental units, even though they do not constitute a State or local government bond. In addition, the provision makes it clear that student loan incentive payments made by the Commissioner of Education under the Emergency Insured Student Loan Act of 1969 are not to result in the treatment of the obligations as arbitrage bonds and in this manner disqualify the financing of these student loan programs for tax-exempt status. (This provision was added by the Finance Committee.)

Sec. 9. Interest on Certain Deposits, etc., in the United States (p. 22)

The provision deals with the exclusion from gross income of interest on U.S. bank deposits held by nonresident aliens. Under present law, interest received by nonresident aliens from deposits with banks, with savings and loan institutions or other similar associations, and from amounts held by an insurance company under an agreement to pay interest is exempt from the 30-percent withholding tax on income or gain not effectively connected with the conduct of a trade or business within the United States. This provision, however, expires as of December 31, 1975. The Senate provision extends the termination of this provision for one additional year to December 31, 1976. (The provision was added by the Finance Committee and is a part of sec. 351 of H.R. 17488.)

Sec. 10. Exclusion of Interest on Certain Obligations Issued Prior to 1971 (p. 22)

The Senate provision specifies that (1) where companies had issues of indebtedness outstanding on the date of the enactment of the interest equalization tax, (2) which were guaranteed by U.S. persons, (3) which were treated under that Act as debt obligations of a foreign obligor, (4) the obligation does not have a maturity date exceeding 15 years as of June 30, 1974, and (5) the obligation has been purchased by one or more underwriters with the purpose of distribution through resale, then the interest on the obligations is to be treated as foreign source income and as a result exempt from the 30-percent withholding tax in the case of interest payments to nonresident aliens. In addition, these obligations are to be exempt from U.S. estate tax when held by nonresident aliens. Since the interest equalization tax (under which these obligations were exempted from withholding tax) is no longer in effect, the only way finance subsidiaries can continue to avoid payment of the withholding tax is for their U.S. parent company to assume these obligations. However, this would cause the finance subsidiaries to realize income from the discharge of indebtedness. For this reason, these types of obligations were made exempt from the 30-percent withholding tax. (The provision was added by the Finance Committee.)

Sec. 11. Tax on Certain Income of Political Organizations (p. 24)

The Senate provision specifies that political parties or committees (and separate campaign funds) are to be taxed on investment income and on income from a trade or business, but not on campaign contributions they receive. In addition, a $100 minimum is to be provided before any tax is payable on investment or business income. Generally, the political parties and committees are to be taxed as corporations but the surtax exemption is not to be allowed and the dividends received deduction is not to be available.

Generally, newsletter committees (and separate funds) are to be treated for tax purposes in the same way as political campaign committees. That is, contributions received by the newsletter committees are not to be taxable to the individual or committee nor are the funds spent for a newsletter to be deductible. However, to the extent of any investment income or business income in the case of these funds, tax is to be imposed. Should funds be withdrawn from newsletter funds for personal purposes, however, tax is to be imposed at that time. (The Senate provision was added by the Finance Committee and is the same as sec. 271 of H.R. 17488.)

Sec. 12. Extension of Existing Credit and Deduction Provisions for Political Contributions to Contributions for Newsletters; 2-year Rule for Announcing Candidacy (p. 32)

The Senate provision extended the existing credit and deduction provisions for political contributions to contributions to newsletter funds.

The limited credit or deduction allowed under present law for campaign contributions to individual candidates (and parties and committees) is available only if a person has announced that he is a candidate for office in the year of the contribution. The provision allows this credit or deduction in the year before a person announces his candidacy. (The Senate provision was added by the Finance Committee and is the same as section 272 of H.R. 17488.)

Sec. 13. Increase in Political Contributions Credit and Deductions (p. 34)

The Senate provision increases the maximum credit and deduction for contributions to candidates for public office. The maximum credit is increased from $12.50 ($25 in the case of a joint return) to $25 ($50 in the case of a joint return). The maximum deduction is increased from $50 ($100 in the case of a joint return) to $100 ($200 in the case of a joint return). (This provision was added by a Senate floor amendment sponsored by Senator Kennedy.)

Sec. 14. Transfer of Appreciated Property to Political Organizations (p. 35)

Appreciated property transferred by a taxpayer to a political party or committee, if occurring after May 7, 1974, is to be taxed to the donor at the time of the transfer. A ruling already issued by the Internal Revenue Service taxes appreciation in property given before that date to the political party or committee receiving the property. However, this ruling is not to apply before August 2, 1973. The Senate provision was added by the Finance Committee and is identical to sec. 273 of H.R. 17488.)

Sec. 15. Gift Tax Not To Apply to Contributions to Political Organizations, (p. 3)

Gift taxes are not to apply to contributions to political parties or committees. (The Senate provision was added by the Finance Committee and is identical to sec. 274 of H.R. 17488.)

Sec. 16. Exemption of Interest on Certain Governmental Obligations (p. 37)

The Senate provision exempts from Federal taxation the interest on obligations issued by the American Falls Reservoir District to finance and construct a dam and related facilities to replace the existing American Falls Dam of the Minidoka project, Idaho-Wyoming, pursuant to a contract with the Secretary of Interior under authority contained in the Act of December 28, 1973 (87 Stat. 904). (This provision was added by a Senate floor amendment sponsored by Senator McClure.)

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