[JOINT COMMITTEE PRINT]

DESCRIPTION OF TAX BILLS LISTED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT GENERALLY

OF THE

COMMITTEE ON FINANCE

ON FEBRUARY 29 AND MARCH 4, 1980

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BY THE STAFF OF THE

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INTRODUCTION

The bills described in this pamphlet have been scheduled for hearings on February 29 and March 4, 1980, by the Senate Finance Subcommittee on Taxation and Debt Management Generally. There are 13 Senate bills and three House-passed bills described in the pamphlet.

The first part of the pamphlet is a summary of the bills generally presented in bill numerical order for Senate bills and then for House-passed bills. This is followed by a more detailed description of the bills, setting forth present law, the issues involved, an explanation of the bills, the effective dates, and the estimated revenue effects.

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I. SUMMARY OF BILLS

A. SENATE BILLS

1. S. 464—Senator Inouye

Extension of Targeted Jobs Tax Credit to Displaced Homemakers

Under present law, an income tax credit is provided for the hiring of certain categories of individuals. In general, the amount of the credit is equal to 50 percent of qualified first-year wages and 25 percent of qualified second-year wages.

The bill would add displaced homemakers to the categories of targeted groups eligible for the jobs credit.

2. S. 485—Senators Cannon and Laxalt

Exemption From Excise Tax on Wagers and Occupational Tax on Wagering in States Authorizing Wagering

Under present law, a 2-percent excise tax is imposed on the amount of certain wagers. In addition, an annual $500 occupational tax is imposed on a person who is liable for the excise tax or who receives wagers subject to the tax. These taxes do not apply with respect to pari-mutuel wagering, a wager placed in a coin-operated device, or a wager in a State-conducted lottery.

Under the bill, the 2-percent tax would not apply to any wager authorized under State law and the annual $500 occupational tax would not apply to a person authorized by State or local law to engage in the business of accepting wagers or to receive wagers on behalf of another person.

3. S. 650—Senator Moynihan

Treatment of Certain Employees' Trusts Organized To Invest in Real Estate

Generally, under present law, if an otherwise tax-exempt trust forming part of a qualified pension, profit sharing, or stock bonus plan ("qualified retirement plan") invests in debt-financed property, all or a portion of the income derived from such property is treated as unrelated to the exempt functions of the trust and therefore is subject to an income tax on unrelated business taxable income.

The bill would prescribe qualification rules for a group real estate employee benefit trust in which at least ten or more qualified retirement plans maintained by ten or more employers participate. Subject to certain investment and other conditions, a group real estate employee benefit trust would be a tax qualified trust established to invest in real estate in the United States or Puerto Rico. Unlike other trusts forming part of qualified retirement plans, a group real estate employee benefit trust would not be subject to the tax on unrelated debt-financed income.

4. S. 1194—Senator Heflin

Unemployment Tax Status of Certain Fishing Boat Services

Under present law, certain crew members of fishing boats are treated as self-employed individuals rather than as employees for purposes of the Federal Insurance Contributions Act (FICA) and income tax withholding. However, services which are not subject to FICA taxes are not exempt for purposes of the Federal Unemployment Tax Act (FUTA) if the services are related to catching halibut or salmon for commercial purposes or if the services are performed on a vessel of more than ten net tons.

The bill would exclude from coverage, for purposes of FUTA, those services of fishing boat crew members which currently are excluded for purposes of FICA and income tax withholding.

5. S. 1831—Senator Talmadge

Net Operating Loss Deduction of Former Real Estate Investment Trusts

The bill would permit trusts which were former real estate investment trusts (REITs) an additional year to carryover operating losses for each year a carryback was not allowed because it was a REIT in the carryback year. The maximum carryover period would be 8 years.

6. S. 1859—Senators Percy and Dole and S. 2201—Senator Bellmon

Special Estate Tax Valuation of Farm Real Property

Under present law, certain farm real estate may be included in a decedent's gross estate for estate tax purposes at its current use value rather than its highest and best use value. In general, the current use valuation may be determined under a "multiple factor" approval or by a capitalization of income formula that is primarily based on cash rentals for comparable farm land.

The bill, S. 1859, would provide that if there is no comparable land from which to determine the average gross cash rental, then the average net share rental could be substituted for the average gross cash rental in applying the formula method of valuation. The bill, S. 2201, contains substantially identical provisions.

7. S. 1900 and S. 1901—Senator Heflin

Amount of Casualty Loss Deduction for Timber and Fruit or Nut Trees

Under present law, the deduction for a casualty loss is limited to the amount of the taxpayer's adjusted basis in the damaged property.

The bill, S. 1900, would provide that, in the case of fruit and nut trees, the loss limitation would be the greater of the taxpayer's adjusted basis in the damaged property or its fair market value before the casualty occurred. The bill, S. 1901, would provide similar treatment for casualty losses of timber. Under the bills, a special loss carryback rule of 10 taxable years and carryover period of 4 taxable years would apply respectively to casualty losses to fruit and nut trees and to timber.

8. S. 2089—Senators Roth, Helms, and Talmadge

Waiver of Period of Limitations for Claiming Refunds for Single Purpose Agricultural Structures

Under the bill, a claim for refund filed within one year of enactment would be allowable notwithstanding expiration of the period of limitations for refunds with respect to single purpose agricultural structures qualifying for the investment tax credit under the Revenue Act of 1978.

9. S. 2167—Senator Stone

Taxation of Certain Homeowners Associations at the Corporate Graduated Rates

Under present law, a qualified homeowners association is not taxed on its exempt function income. Other income, less certain deductions, is taxed at the highest corporate rate of 46 percent. The bill would permit this income to be taxed at the corporate graduated rates.

10. S. 2180—Senator Byrd (of Virginia)

Replacement Period for Nonrecognition of Gain on Sale of Residence

In general, gain on the sale of a taxpayer's principal residence will not be recognized for income tax purposes if a replacement residence is purchased or constructed and certain requirements are met within specified time periods.

The bill would, under limited circumstances, require the Secretary of the Treasury to extend to five years the present two-year period during which a taxpayer must occupy and use as a principal residence a newly constructed replacement residence. The bill is intended to benefit Mrs. Jane M. Cathcart of Virginia.

11. S. 2275—Senator Gravel

Technical Amendments to the Provisions Relating to General Stock Ownership Corporations

Under present law, a State is authorized to establish a general stock ownership corporation (GSOC) for the benefit of all its citizens. It is anticipated that the GSOC will be permitted to borrow money to invest in business enterprises. The cash flow from the operation of the business would be used to service and repay the loan, and the remaining cash would be distributed to the GSOC shareholders (i.e., all the citizens of the State). A corporation must meet certain statutory tests in order to be treated as a GSOC. Generally, a GSOC is exempt from Federal income taxation. Instead, the shareholders of the GSOC would report their proportionate part of the GSOC's taxable income on their Federal individual income tax returns.

The bill would make several technical changes in the tax law relating to GSOCs.

B. HOUSE-PASSED BILLS

1. H.R. 4746

Section 1. Simplification of private foundation return and reporting requirements

This section combines information reporting requirements for private foundations so that only one return would have to be filed to furnish information now required on two separate returns. It also provides that nonexempt wholly charitable trusts would be required to report the same information and be subject to the same disclosure requirements as exempt charitable organizations. Finally, it provides that disclosure of the name and address of an indigent or needy person receiving a grant of less than $1,000 in any year need not be made.

Section 2. Treatment of payment or reimbursement by private foundations for expenses of foreign travel by government officials

Present law, in effect, prohibits any "self-dealing" between private foundations and "disqualified persons." Under these rules, any payment or reimbursement by a private foundation of expenses of government officials generally is classified as an act of self-dealing. However, a limited exception in existing law permits a private foundation to pay or reimburse certain expenses of government officials for travel solely within the United States.

This section of the bill broadens this existing exception to permit a private foundation (other than a foundation supported by any one business enterprise, trade association, or labor organization) to pay or reimburse government officials for certain expenses of foreign travel under similar types of limitations as apply under current law in the case of expenses for domestic travel.

Section 3. Alternative minimum tax on charitable lead trusts created by corporations

Under present law, the alternative minimum tax may be imposed on a charitable lead trust set up by a corporation because the deduction for income paid to charity is treated as an adjusted itemized deduction preference. However, if the corporation had made a contribution to charity directly instead of through a charitable lead trust, there would be no alternative minimum tax because corporations are not subject to this tax.

This section of the bill provides that the charitable deduction of a charitable lead trust will not be considered in determining the adjusted itemized deduction preference for purposes of the alternative minimum tax if the grantor of the trust and the owner of all reversionary interests in the trust is a corporation.

Section 4. Extension of withholding to payments of sick pay made by third parties

Under present law, no tax is specifically required to be withheld upon payments of sick pay made to an employee by a person who is not the employer for whom the employee performs services. For example, no tax is withheld from payments of sick pay made on behalf of an employer by an insurance company under an accident or health policy.

In general, this section of the bill provides for voluntary withholding from payments of sick pay made by a third party. In addition, it contains a special provision relating to sick pay paid pursuant to certain collective-bargaining agreements and contains various reporting requirements.

Section 5. Treatment of certain repayments of supplemental unemployment compensation benefits

Under present law, if a worker who has been laid off is required to pay back supplemental unemployment compensation benefits because of the subsequent receipt of trade readjustment assistance, the worker may be entitled to tax relief in the year of repayment under a special tax computation for cases where the taxpayer restores a substantial amount held under a claim of right (Code sec. 1341). However, if the amount of supplemental unemployment compensation benefits required to be paid back by the worker is $3,000 or less, the worker may not be eligible for any tax relief for the repayment of previously taxed amounts unless itemized deductions are claimed.

This section of the bill would allow a deduction from gross income for the repayment of supplemental unemployment compensation benefits if the repayment is required because of the receipt of trade readjustment allowances.

Section 6. Disclosure of tax returns to State audit agencies

Present law authorizes the disclosure of returns and return information to State agencies, which are charged under the laws of the State with responsibility for the administration of State tax laws, for the purpose of, and only to the extent necessary in, the administration of such laws.

This section of the bill would permit State taxing authorities to disclose Federal tax return information in their possession to State auditing agencies for the purpose of auditing the activities of the State taxing authority.

Section 7. Investment tax credit for certain property used in maritime satellite communications

Under present law, the investment credit is not generally available for property used outside the United States or for property used by an international organization. Under the Revenue Act of 1971, these limitations were made inapplicable to interests of United States persons in communications satellites used by the International Telecommunications Satellite Organization (INTELSAT). This permitted the Communications Satellite Corporation (COMSAT), the governmentally designated United States participant in INTELSAT, to obtain the credit on its share of qualifying investments made by the INTELSAT joint venture.

This section of the bill would similarly make the credit available for interests of United States persons in communications satellites used by the International Maritime Satellite Organization (INMARSAT), an international organization established to develop and operate a global maritime satellite telecommunications system.

Section 8. Rate of interest on United States retirement bonds

Under present law, the interest rate on an individual retirement bond issued by the Treasury Department or a retirement plan bond issued by the Treasury Department remains the same from the date of issuance until the bond is redeemed (generally when the owner retires, becomes disabled, or dies).

This section of the bill would authorize the Treasury Department to make upward adjustments in the interest rate on outstanding retirement bonds, so that such a bond would earn interest at a rate consistent with the yield for new issues of such bonds.

2. H.R. 5505 [1]

Section 7. Change of time for paying excise tax on fishing equipment [2]

Present law imposes a 10-percent excise tax upon the sale of fishing rods, creels, reels, and artificial lures, baits, and flies by the manufacturer, producer or importer thereof. This tax generally is payable relatively soon after such fishing equipment is sold.

This section provides that the excise tax on fishing equipment sold during quarters ending on December 31, March 31, and June 30 would be payable, respectively, on March 31, June 30, and September 24. For the quarter ending September 30, the tax will be due by the date specified by Treasury regulations.

Section 8. Excise tax treatment of domestic wines for certain uses

This section eliminates a distinction between the excise tax treatment of domestic and imported wines so that domestic wines, like imported wines, may be transferred to customs bonded warehouses without payment of tax. In addition, the provision will allow tax-free sales of wines from customs bonded warehouses to foreign embassies, international organizations and related individuals for authorized purposes, as is allowed distilled spirits under present law. These provisions will become effective for the first calendar month which begins more than 90 days after enactment.

Section 9. Refunds of tread rubber excise tax

Under present law, a 5-cents-per-pound manufacturers excise tax is imposed on tread rubber used for recapping or retreading tires of the type used on highway vehicles. No credit or refund of the tread rubber tax is available if the tax-paid tread rubber is wasted in the recapping process, contained in a recapped tire the price of which is adjusted under a warranty, or sold in conjunction with certain otherwise tax-exempt sales. In some situations, the tread rubber tax can be avoided by exporting a tire to be recapped outside the United States and then importing the retreaded tire.

This section provides for a refund or credit of the manufacturers excise tax on tread rubber where the rubber is (1) wasted in the re-

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[1] Provisions in the House-passed bill relating to the simplification of certain procedure rules (secs. 2–6 of the bill) and extensions of expiring tax provisions (sec. 12 of the bill) were enacted as part of Public Law 96–167 (H.R. 5224) in 1979.

[2] This provision has been reported by the Senate Finance Committee in H.R. 1212 (S. Rept. No. 96–532, sec. 403).

capping process, (2) contained in a recapped tire the price of which is adjusted under a warranty, or (3) sold in conjunction with certain otherwise tax-exempt sales.

The provision also imposes the tread rubber excise tax on the tread rubber in tires which are exported for recapping and subsequently imported into the United States.

Section 10. Nonrecognition of gain on sale of residence for certain members of the Armed Forces

Under present law, a member of the Armed Forces serving on extended active duty generally is not required to recognize gain on the sale of a principal residence if he or she purchases and uses a new principal residence within four years after the date of the sale of the old residence.

This section extends the replacement period for members of the Armed Forces who are stationed outside of the United States or who are required to reside in Government-owned quarters to the later of: (1) four years after the date of the sale of the old residence, or (2) one year after the date on which the member no longer is stationed outside of the United States or required to reside in Government-owned quarters.

Section 11. Exempt status of auxiliaries of certain fraternal beneficiary societies

In order to qualify for tax-exempt status under Code section 501 (c) (7) after October 20, 1976, a social club cannot have any provision providing for discrimination against any person on the basis of race, color, or religion in the club's charter, bylaws, other governing instrument, or any written policy statement.

This section allows social clubs which are affiliated with fraternal beneficiary societies exempt under Code section 501(c)(8), such as those operated by the Knights of Columbus, to retain their exemption even though membership in the clubs is limited to members of a particular religion.

3. H.R. 5973

Section 1. Waiver of time limits in foreign residence or presence requirements for Americans working abroad [1]

This section would permit the waiver of the minimum time limits in the foreign residence or presence eligibility requirements for Americans working abroad to obtain the benefits of the deduction for excess foreign living costs or the exclusion for foreign earned income. The waiver generally would be available to Americans working abroad who could reasonably have been expected to meet those eligibility requirements, but who left the foreign country under conditions of war, civil unrest, or similar conditions which precluded the normal conduct of business.

Section 2. Special rule for certain distributions from money purchase pension plans [2]

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

Section 3. Definition of youth participating in a qualified cooperative education program for purposes of the targeted jobs credit [3]

Under present law, the targeted jobs credit may be claimed for the hiring of youths who actively participate in qualified cooperative education programs, who have attained the age of 16 but who have not

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[1] In principle, this provision was approved by the Senate Finance Committee on December 6, 1979. The Subcommittee on Taxation and Debt Management Generally held a hearing on S. 873, which contains similar provisions, on November 7, 1979.

[2] As reported by the Senate Finance Committee, H.R. 1212 contains an identical provision (S. Rept. No. 96–532, sec. 405).

[3] As reported by the Senate Finance Committee, H.R. 2797, the Technical Corrections Act of 1979, contains an identical provision (S. Rept. No. 96–498, sec. 103 (a)(6)(F)).

attained the age of 19, and who have not graduated from high school or vocational school. This section would extend the availability of the targeted jobs credit to wages paid on or after November 27, 1979, to such youths who have not attained the age of 20.

Section 4. Special rule relating to debt-financed income of exempt organizations

Generally, under present law, passive investment income and gains from the sale of investments realized by an exempt organization are not subject to tax as unrelated business income. However, income and gains realized by an exempt organization from "debt-financed property" not used for its exempt function are subject to tax in the proportion in which the property is financed by acquisition indebtedness.

This section would provide a limited exception to the debt-financed income rules. This exception would allow certain sales of real property in 1976 to be made free of the unrelated business income tax if the property had been acquired prior to 1952 and the indebtedness was incurred before 1965. The intended beneficiary of the provision is the Tillamook County YMCA of Tillamook, Oregon.

II. DESCRIPTION OF BILLS

A. SENATE BILLS

1. S. 464—Senator Inouye

Extension of Targeted Jobs Tax Credit to Displaced Homemakers

Present law

In general, present law provides an income tax credit for the hiring of individuals who are members of one of seven targeted groups (Code sec. 51). Specifically, the credit is available for the hiring of: (1) recipients of Supplemental Security Income, (2) handicapped individuals undergoing vocational rehabilitation, (3) individuals of ages 18 through 24 who are members of economically disadvantaged families, (4) Vietnam-era veterans under the age of 35 who are members of economically disadvantaged families, (5) recipients of general assistance for 30 or more days, (6) individuals of ages 16 through 18 [1] who are participants in a qualified cooperative education program, and (7) convicts who are members of economically disadvantaged families (if they are hired within 5 years after the date of release from prison or date of conviction).

The amount of targeted jobs credit which may be claimed with respect to any individual is equal to 50 percent of the first $6,000 of qualifying trade or business wages for the first year of employment and 25 percent of such wages for the second year of employment.

Issue

The issue is whether the targeted jobs tax credit should be made available with respect to the hiring of displaced homemakers.

Explanation of the bill

The bill would add displaced homemakers to the categories of targeted groups eligible for the credit.

Under the bill, a "displaced homemaker" would be defined by reference to the Comprehensive Employment and Training Act of 1978 (29 USC 802). Under that Act, a "displaced homemaker" is an individual who has not worked in the labor force for a substantial number of years but has, during those years, worked in the home providing unpaid services for family members; has been dependent on public assistance or on the income of another family member but is no longer supported by that income (or is receiving public assistance on account

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[1] Under a House-passed bill, H.R. 5973, the credit would be extended to 19-year olds participating in qualified cooperative education programs. As reported by the Senate Finance Committee, the Technical Corrections Act of 1979 (secs. 103(a)(6)(F) and (b) of H.R. 2797) contains an identical provision.

of dependent children in the home); and is unemployed or underemployed and is experiencing difficulty in obtaining or upgrading employment.[2]

Effective date

The bill would apply with respect to amounts paid or incurred after December 31, 1978, in taxable years ending after such date.

Revenue effect

It is estimated that this bill would reduce budget receipts by $350 million in fiscal year 1980, $389 million in fiscal year 1981, $266 million in fiscal year 1982, $39 million in fiscal year 1983, and less than $5 million in fiscal year 1984.

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[2] In general, an underemployed person is a person who is working part-time but seeking full-time work; or a person who is working full time but whose current annualized wage rate is not in excess of the higher of the poverty level or 70 percent of the lower living standard income level. An unemployed person is a person who is without a job for a period of at least 7 consecutive days; a person who is a client of a sheltered workshop or institutionalized in a hospital, prison, or similar institution; a person who is 18 years of age or older and whose family receives public assistance or whose family would be eligible to receive public assistance but for the fact that both parents are in the home; or a person who is a veteran who has not obtained permanent unsubsidized employment since being released from active duty. (See 20 CFR sec. 675.4).

2. S. 485—Senators Cannon and Laxalt

Exemption from Excise Tax on Wagers and Occupational Tax on Wagering in States Authorizing Wagering

Present law

Under present law, a 2-percent excise tax is imposed on the amount of certain wagers. For this purpose, a wager means (1) a wager placed with a person who is in the business of accepting wagers on the outcome of a sports event or contest, (2) a wager with respect to a sporting event or contest placed in a wagering pool conducted for profit, and (3) a wager placed in a lottery conducted for profit (including the numbers game, policy, and similar types of wagering). However, this excise tax is not imposed on (1) wagers placed with a parimutuel licensed under State law, (2) wagers placed in coin-operated gaming devices (e.g., slot machines) and (3) State-conducted wagering (e.g., sweepstakes and lotteries). Under present law, the 2-percent excise tax is imposed on so-called off-track betting authorized by State law.

Every person engaged in the business of accepting wagers is liable for the tax with respect to wagers on which the tax is imposed.

Under present law, a special occupational tax of $500 per year is imposed on each person who is liable for the 2-percent excise tax on wagers and on each person who is engaged in receiving wagers for such person.

Issues

The issues are whether the 2-percent excise tax should be imposed on wagers which are authorized by State law and whether a person authorized under State or local law to receive wagers should be subject to the occupational tax on wagering.

Explanation of the bill

Under the bill, the 2-percent excise tax on certain wagers would not apply to wagers authorized by State law. Also under the bill, the occupational tax would not apply to a person authorized by State or local law to engage in the business of accepting wagers. The exemption from the occupational tax would apply only with respect to the wagering business authorized under State or local law.

Effective date

The bill would apply to taxable periods beginning after June 30, 1979.

Revenue effect

It is estimated that this bill would reduce budget receipts by $12 million in fiscal year 1980, $13 million in fiscal year 1981, $14 million in fiscal year 1982, and $15 million per year in fiscal years 1983 and 1984.

3. S. 650—Senator Moynihan

Treatment of Certain Employees' Trusts Organized to Invest in Real Estate

Present law

Under present law, a trust maintained pursuant to a qualified pension, profit sharing, or stock bonus plan ("qualified retirement plan") is generally not subject to tax on the income or gain derived from the investment of its assets. However, such a trust, with certain exceptions, is subject to the tax on unrelated business taxable income where the trust has income from unrelated debt-financed property.[1] Debt-financed property is any property (e.g., real estate, personal property, and corporate stocks) held to produce income and as to which there is an acquisition indebtedness (e.g., debt incurred by the trust in acquiring or improving the property) at any time during the taxable year of the trust or during the prior 12 months if the property is disposed of during the year. Income from debt-financed property is subject to tax generally in proportion to the ratio of the acquisition indebtedness on the property over the adjusted basis of the property.

Issue

The issue is whether qualified retirement plans should be able to jointly participate in a group real estate employee benefit trust and not be subject to the tax on unrelated debt-financed income.

Explanation of the bill

The bill would extend tax-exempt treatment to a group real estate employee benefit trust. In general, a qualified trust would be one established by ten or more qualified retirement plans maintained by ten or more employers to invest primarily in real estate located in the United States or Puerto Rico.

The qualified status of a participating trust would not be affected by participation in the group real estate employee trust if the adjusted cost of its interest in a group real estate employee benefit trust was less than 25 percent of the aggregate adjusted cost of its assets at the end of each quarter of its plan year.

If a trust qualified as a group real estate employee benefit trust, it generally would be exempt from tax like a trust under a qualified retirement plan. However, unlike a trust under a qualified retirement plan, a group real estate employee benefit trust would be exempt under most circumstances from the tax on unrelated debt-financed income.

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[1] The unrelated debt-financed income provisions do not apply with respect to the investment of retirement plan funds which are either held by an insurance company in a segregated asset account (Code sec. 801(g)) or a common trust fund maintained by a bank (Code sec. 584).

To qualify as a group real estate employee benefit trust, the trust would have to be established and maintained in the United States and at all times during its taxable year would have to meet the following requirements: (1) the aggregate adjusted cost of the real property located in the United States and Puerto Rico held by a trust would have to exceed $10 million; (2) at least 75 percent of the adjusted cost of the trust's property would have to be real property located in the United States or Puerto Rico, cash or Government securities; (3) no qualified retirement plan participating in the trust could have more than a 50 percent interest in the trust; (4) the trust would not be permitted to lease real property to a person from whom it acquired such property; (5) the trust could not own land used in farming; and (6) all of the real property owned by a trust would have to be managed by an investment manager.

In addition, the instrument governing a real estate employee benefit trust would have to provide that (1) the assets of the trust could not be commingled with other property; (2) only qualified retirement plans could participate in the trust; (3) the portion of the trust which equitably belongs to a qualified retirement plan would be used for the exclusive benefit of that plan's participants and beneficiaries; (4) the income and corpus of the trust would be allocated according to a participating plan's interest and (5) a participating plan could not assign its interest in the trust.

Effective date

The provisions of the bill would be effective on January 1, 1980.

Revenue effect

It is estimated that this bill will reduce budget receipts by relatively small amounts during the next few years, probably less than $10 million annually. Eventually, it could have significant revenue effect.

4. S. 1194—Senator Heflin

Unemployment Tax Status of Certain Fishing Boat Services

Present law

Under present law (Code sec. 3121(b)(20)), services performed by members of the crew on boats engaged in catching fish or other forms of aquatic animal life are exempt from the tax imposed by the Federal Insurance Contributions Act (FICA) if their remuneration is a share of the boat's catch (or cash proceeds from the sale of a share of the catch) and if the crew of such boat normally is made up of fewer than ten individuals. In the case of an operation involving more than one boat, the exemption applies if the remuneration is a share of the entire fleet's catch or its proceeds, and if the operating crew of each boat in the fleet normally is made up of fewer than ten individuals.

In addition, the remuneration received by those fishing boat crew members whose services are exempt for purposes of FICA is not considered to be "wages" for purposes of income tax withholding (Code sec. 301(a)(17)) and those individuals are considered to be self-employed for purposes of the Self-Employment Contributions Act (Code sec. 1402(c)(2)(F)). However, the employer of such individuals whose services are exempt for FICA purposes, and whose remuneration is not subject to income tax withholding, is not exempt from tax under the Federal Unemployment Tax Act (FUTA) if the services performed are related to catching halibut or salmon for commercial purposes or if the services are performed on a vessel of more than ten net tons.

Issue

The issue is whether the services of fishing boat crew members, which currently are exempt for purposes of FICA, also should be exempt for purposes of FUTA.

Explanation of the bill

The bill would exempt, for purposes of FUTA, the services of fishing boat crew members which currently are exempt for purposes of FICA. Thus, services by members of the crew on boats engaged in catching fish or other forms of aquatic animal life would be exempt for purposes of FUTA if the remuneration for those services is a share of the boat's catch or of the proceeds of the catch and if the crew of such boat normally is made up of fewer than ten individuals. In the case of an operation involving more than one boat, services would be exempt for purposes of FUTA if the remuneration for services is a share of the entire fleet's catch or its proceeds, and if the operating crew of each boat in the fleet normally is made up of fewer than ten individuals.

Effective date

The provisions of the bill would apply to services performed by fishing boat crew members after December 31, 1978.

Revenue effect

It is estimated that this bill would reduce budget receipts by less than $1 million per year.

Prior Congressional action

An identical bill (H.R. 3080) was the subject of hearings in the Subcommittee on Taxation and Debt Management Generally of the Senate Finance Committee during the 95th Congress (July 24, 1978).

5. S. 1831—Senator Talmadge

Net Operating Loss Deduction of Former Real Estate Investment Trusts

Present law

Prior to the Tax Reform Act of 1976, real estate investment trusts (REITs) were not allowed to carryover or carryback net operating losses. Because of the effect that this rule had during the economic downturn in the early 1970's, many trusts terminated their status as REITs in order that they could carryover net operating losses incurred by them during those years. In such a case, a trust was allowed to carryover its losses for five years. However, unlike other taxpayers, such trusts could not carryback the net operating loss to years before the loss year during which they qualified as a REIT.

The Tax Reform Act of 1976 made two changes that affected the net operating loss carryovers of corporations and REITs. First, it lengthened the time that corporations could carryover their net operating loss deductions from five years to seven years. This change was effective for losses incurred in years ending after December 31, 1975. Because of this effective date, losses incurred before 1976 by trusts which had terminated their REIT status were subject to the five-year carryforward of losses instead of the seven-year carryforward.

The Tax Reform Act of 1976 also changed the treatment of net operating losses of REITs. Under the 1976 Act, a REIT is permitted to carryforward a net operating loss for eight years. However, no net operating loss carrybacks are permitted. This change in rules was effective for taxable years of a REIT ending after October 4, 1976. As a result of this effective date, losses incurred before 1976 by REITs were subject to an eight-year carryforward if they retained their REIT status during the entire eight-year carryforward period. However, under the 1976 Act rule, a net operating loss incurred before 1976 could not be carried over to the 6th, 7th, or 8th carryforward year unless the corporation was a REIT for all years from the loss year through the carryover year.

Thus, where a trust which was a REIT has terminated its status in its three taxable years ending before October 4, 1976 and incurred losses in those years, less than an eight-year carryover is permitted. This is so even though the trust would have been given an eight-year carryforward had it retained its REIT status and even though it would have been given a combined eight years of carrybacks and carryforwards had the trust never become a REIT.

Issue

The issue is whether a trust, which was formerly a REIT, should be allowed an additional year of carryforward of net operating losses for each year that the trust was not permitted to carry back its net operating loss deduction because it qualified as a REIT in the year to which the loss would be carried back.

Explanation of the bill

The bill would allow a trust which was formerly a REIT an additional year of carryforward (with a maximum of eight years) of net operating losses for each year that it is denied a net operating loss carryback because it was a REIT. This would have the effect of allowing a former REIT to have a total of eight carryover years, as compared to all other corporations and qualifying REITs, even though the trust terminated its status as a REIT with the exception that it could carryover its pre-1976 net operating losses for only five years. each year that the trust was not permitted to carryback its net operatating loss incurred before 1976 can be carried forward to the 6th, 7th, or 8th year only if it qualified as a REIT for all years from the loss year through the carryover year.

Effective date

The provisions of the bill would be effective for taxable years ending after October 4, 1976.

Revenue effect

This bill is estimated to reduce budget receipts by a negligible amount through fiscal year 1982, $7 million in fiscal year 1983, and $15 million in fiscal year 1984. This estimate assumes that there is no significant increase in acquisitions under which net operating loss carryovers become available to acquiring corporations or continue to be available to corporations purchased by new owners.

6. S. 1859—Senators Percy and Dole and S. 2201—Senator Bellmon

Special Estate Tax Valuation of Farm Real Property

Present law

For estate tax purposes, real property must ordinarily be valued at its highest and best use. If certain requirements are met, however, present law allows family farms and real property used in a closely held business to be included in a decedent's gross estate at current use value rather than highest and best use value, provided that the gross estate may not be reduced more than $500,000 (Code sec. 2032A).

The current use value of qualified farm property may be determined in two ways, the multiple factor method (sec. 2032A(e)(8)), and the formula method (sec. 2032A(e)(7)(A)). The multiple factor method takes into account factors normally used in the valuation of real estate, for example, comparable sales, and any other factors that fairly value the farm property. The formula method may be used only if there is comparable land from which the average annual gross cash rental may be determined.

Under the formula method, the value of qualified farm property is determined by (1) subtracting from the average annual gross cash rental for comparable land used for farming the average annual State and local real estate taxes for the comparable land, and (2) dividing that amount by the average annual effective interest rate for all new Federal Land Bank loans.[1]

On July 19, 1978, the Department of the Treasury issued proposed regulations defining gross cash rental for purposes of the formula method.[2] Under the proposed regulations, if no comparable farm property had been leased on a cash basis, then the formula method could be applied by converting crop share rentals into cash rentals. If the crops were sold for cash in a qualified transaction, the selling price would be considered the gross cash rental. If no qualified sale occurred, then the gross cash rental would equal the cash value of the crops on the date received on an established public agricultural commodities market.

On September 10, 1979, the Department of the Treasury withdrew the portion of the regulations relating to gross cash rental proposed in July and published another proposed regulation defining gross cash rental.[3] The new proposed regulation provides that crop share rentals may not be used under the formula method. Consequently, under that

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[1] Each average annual computation must be made on the basis of the five most recent calendar years ending before the decedent's death.

[2] 43 Fed Reg. 31,039 (1978).

[3] 44 Fed. Reg. 52,696 (1979).

proposed regulation, if no comparable land is rented solely for cash, the formula method may not be used and the qualified farm property may be valued only by the multiple factor method.

Issue

The issue is whether qualified farm property may be valued under the formula method by using crop share rentals if no comparable land is leased solely for cash and comparable land is leased partially or completely on a crop share basis.

Explanation of the bills

S. 1859

The bill, S. 1859, would provide that if there is no comparable land from which to determine the average annual gross cash rental, then the average net share rental could be substituted for the average gross cash rental in applying the formula method. The net share rental would be (1) the value of the produce grown on the leased land received by the lessor, reduced by (2) the cash operating expenses of growing the produce that are paid, under the terms of the lease, by the lessor.

S. 2201

The bill, S. 2201, contains provisions which are substantially identical to those contained in S. 1859.

Effective date

The provisions of S. 1859 and S. 2201 would apply to estates of decedents dying after the date of enactment.

Revenue effect

It is estimated that the bills, S. 1859 and S. 2201, would have no effect on fiscal year 1980 budget receipts, and would reduce budget receipts by less than $1 million in fiscal year 1981 and by $25 million per year in fiscal year 1982 and thereafter.

7. S. 1900 and S. 1901—Senator Heflin

Amount of Casualty Loss Deduction for Timber and Fruit or Nut Trees

Present law

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

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

In computing the adjusted basis of property damaged or destroyed by casualty, the taxpayer's cost or other basis is adjusted for capitalized expenditures which become part of the basis, and for deductions for such items as depreciation, amortization, and depletion, which reduce the taxpayer's basis in the property.[1] In the case of timber property, adjusted basis includes the cost of purchasing a stand of timber (other than any part of the cost allocable to land), and also capitalized costs (such as those for site preparation and planting costs) in connection with the planting or seeding of trees for timber purposes.[2] In the case of fruit and nut trees, special capitalization rules apply with respect to expenditures incurred in planting and developing citrus and almond groves and, in the case of certain farming syndicates with respect to expenditures incurred in planting and developing a grove, orchard, or vineyard in which fruit or nuts are grown (sec. 278). In addition, several special deduction allowance rules may affect the determination of adjusted basis of timber and fruit and nut trees, i.e., deductions for soil and water conservation expenditures (sec. 175), expenditures by farmers for fertilizer (sec. 180), and expenditures by farmers for clearing land (sec. 182).

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[1] Depletion of timber is limited to cost depletion and is claimed at the time the timber is harvested (Regs. § 1.611–1). In addition, a taxpayer may elect capital gain treatment for income recognized from the cutting of timber (Code sec. 631(a)).

[2] Under H.R. 1212, as reported by the Committee on Finance (S. Rept. 96–532, 96th Cong., 1st Sess., December 15, 1979), seven-year amortization would be allowed for reforestation expenditures. If this legislation is enacted, basis would be adjusted to reflect amortization deductions allowed or allowable under this provision.

Present law also treats casualty losses as trade or business losses for purposes of computing a net operating loss deduction. As a result, a net operating loss which is created as a result of a casualty loss may generally be carried back as a deduction against income for the three taxable years preceding the taxable year in which the loss occurred and may be carried over as a deduction against income for the seven taxable years following the year of the loss. (sec. 172(b) and (d); Reg. § 1.172–3(a)(3)(iii)). In addition, where a casualty loss is attributable to a disaster in an area which is proclaimed by the President to be a disaster area eligible for federal assistance, the taxpayer may elect to treat the loss as having occurred in the immediately preceding taxable year and the loss may be deducted for this earlier year (Code sec. 165(h)).

Issues

S. 1900

The issues with respect to S. 1900 are (1) whether a taxpayer suffering an otherwise deductible loss of a fruit or nut tree may deduct the fair market value of the tree at the time of the loss, even if such value exceeds the adjusted basis of the tree; and (2) if so, whether any unused amount of the deduction may be carried back 10 years and forward four years.

S. 1901

The issues with respect to S. 1901 are whether the amount of deductible casualty loss on timber should be measured by the fair market value of the timber immediately before the casualty, and whether special carryback and carryover rules should be provided for casualty losses from timber.

Explanation of the bills

S. 1900—Fruit and nut trees

The bill, S. 1900, would provide that a taxpayer suffering a loss in a trade or business with respect to fruit or nut trees which are completely destroyed and for which a depreciation deduction is allowable (determined without regard to the age of the trees or their productivity over their useful life) may deduct the higher of the property's adjusted basis or its fair market value on the date the loss occurs. In the case of a partial loss, the initial determination of the amount of loss would be made as under present law by reference to the decline in value resulting from the casualty. However, under the bill, the basis limitation on the amount of the deductible loss would be applied by using the higher of the property's adjusted basis or its fair market value on the date the loss occurs.

Also, the bill would provide that in the case of an individual, any unused fruit or nut tree loss deduction could be carried back 10 years and, if not offset by income of such prior years, forward for four years.

S. 1901—Timber

The bill, S. 1901, would provide that the amount of deductible loss arising from a casualty loss of timber which is completely destroyed is the fair market value of the timber immediately before the casualty. In the case of a partial loss, the initial determination of the amount of loss would be made as under present law by reference to the decline in value resulting from the casualty. However, under the bill, the basis limitation on the amount of the deductible loss would be applied by using the higher of the property's adjusted basis or its fair market value on the date the loss occurs.

In addition, the bill would treat casualty losses from timber as a separate category of deduction which would be deducted in computing taxable income after other allowable deductions authorized by the Internal Revenue Code. To the extent this deduction creates a loss in the year of the casualty, the excess deduction would be allowed to be carried back to the ten preceding taxable years and carried over to the four taxable years following the year of the casualty.[3]

Effective date

S. 1900

The provisions of S. 1900 would apply to fruit or nut tree losses incurred after August 31, 1979.

S. 1901

The provisions of S. 1901 would be effective for qualifying timber losses which are incurred after August 31, 1979.

Revenue effect

The revenue estimates for S. 1900 and S. 1901 are not yet available but will be furnished at the time of the hearing.

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[3] The effective carryback and carryover periods would be 11 years and 3 years, respectively, if the loss qualifies as a disaster loss and the taxpayer makes the election provided under Code section 165(h).

8. S. 2089—Senators Roth, Helms, and Talmadge

Waiver of Period of Limitations for Claiming Refunds for Single Purpose Agricultural Structures

Present law

Property eligible for the investment tax credit includes tangible personal property (such as machinery and equipment) which is used in a trade or business or for the production of income. The investment credit is also allowed for other tangible property which is used as an integral part of manufacturing, production, extraction, or in furnishing certain utility services, even though such tangible property may otherwise be considered real (and not personal) property under local law. Farming is considered a production activity so that such items as fences, drain tiles, paved barnyards, and water wells are eligible for the credit even though these items would be considered real property under local law.[1]

Under existing law, buildings and their structural components generally are not eligible for the investment credit. Ineligible buildings have been generally considered to include any structure which encloses a space within its walls (and usually covered by a roof) which is used primarily to provide shelter or working space. Examples of buildings include factory and office buildings, warehouses, and barns (Regs. § 1.48–1(e)(1)). While the Internal Revenue Service had ruled that barns, stables, and poultry houses were buildings and were ineligible for the credit, certain single purpose structures have not been considered ineligible buildings.[2] A single (or special) purpose structure which qualifies for the credit is one which houses property used as an integral part of a production activity (including farming) where the structure is so closely related to the use of the property that it is clearly expected to be replaced when the property it houses is replaced. One characteristic of this type of structure is that it cannot be used economically for any purpose other than that related to the property it houses.[3]

The Senate Finance Committee report on the Revenue Act of 1971 stated that single purpose structures used in unitary hog-raising systems would be considered single purpose structures which qualify for the investment credit and would not be considered buildings.[4] The Internal Revenue Service continued to approach the question of eligibility of single purpose farm structures on a case-by-case basis. For example, in three recent cases, the IRS contended that structures which are designed and used for poultry-raising and egg-

[1] Rev. Rul. 66–89, 1966–1 Cum. Bull. 7.
[2] *Ibid.*
[3] Regs. § 1.48–1(e)(1).
[4] S. Rept. No. 92–437, 92d Cong., 1st Sess. (1971), 29–30.

producing activities were not eligible for the investment credit.[5] Although the IRS was reversed in two of these cases, it was understood that the Service continued to adhere to the position that single purpose poultry-raising, livestock raising, and egg-producing structures were not generally eligible for the investment credit.

Greenhouses are structures which provide an environment for the controlled growth of flowers and other plants. These structures also provide working space for persons who care for the flowers and plants within the greenhouse. It was the position of the Internal Revenue Service that greenhouses are buildings and consequently are ineligible for the credit. This position was based on the fact that these structures provide working space for persons tending the plants. The Service's position was sustained in two Tax Court cases decided in 1972.[6] However, the Tax Court was overruled in one of these cases on appeal.[7] In this latter case, the Ninth Circuit Court of Appeals found that the workers' activities in the greenhouse were "merely supportive of, and ancillary to" the principal use of the structure of providing an environment for controlled plant growth.

To resolve these controversies, definitive rules were prescribed under the Revenue Act of 1978, under which single purpose agricultural structures were to be eligible for the investment tax credit. These provisions are effective for open taxable years ending on or after August 15, 1971 (the date on which the investment tax credit was reinstated). However, no provision was made in this legislation for the allowance of refunds which were barred by the expiration of the period of limitations.

Issue

The issue is whether the period of limitations for claiming refunds should be waived with respect to investment tax credits attributable to single purpose agricultural structures which are eligible under the Revenue Act of 1978.

Explanation of the bill

Under the bill, a claim for refund filed within one year of enactment would be allowable notwithstanding expiration of the period of limitations for refunds with respect to qualifying single purpose agricultural structures.

Revenue effect

It is estimated that this bill will reduce budget receipt by $45 million. (This figure represents tax liabilities of prior years. The fiscal year effect depends on the date of enactment of the bill and on the promptness of taxpayers making claims for refunds, but is assumed to be in fiscal years 1980 and 1981.)

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[5] *Melvin Satrum*, 62 T.C. 413 (1974), *conacq.*, 1978–23 Int. Rev. Bull. 7 (June 5, 1978); *Starr Farms, Inc.* v. *U.S.*, 78–1 U.S.T.C. ¶ 9183 (W.D. Ark. 1977); *Walter Sheffield Poultry Co.*, T.C. Memo 1978–308.

[6] *Sunnyside Nurseries*, 59 T.C. 113 (1972); *Arne Thirup*, 59 T.C. 122 (1972).

[7] *Thirup et al.* v. *Comm.*, 508 F. 2d 918, 75–1 U.S.T.C. ¶ 9158 (9th Cir. 1974). This case was followed in *Stuppy, Inc.* v. *United States*, 78–2 U.S.T.C. ¶ 9664 (W.D. Mo. 1978).

9. S. 2167—Senator Stone

Taxation of Certain Homeowners Associations at the Corporate Graduated Rates

Present law

Homeowners associations

Under present law, a qualified homeowners association (a condominium management association or a residential real estate association) may elect to be treated as a tax-exempt organization (Code sec. 528). If an election is made, the association will not be taxed on "exempt function income." Exempt function income means membership dues, fees, and assessments received from persons who own residential units in the particular condominium or subdivision and who are members of the association.

The association will be taxed, however, on income which is not exempt function income. For example, any interest earned on amounts set aside in a sinking fund for future improvements is taxable. Similarly, any amount paid by persons who are not members of the association for use of the association's facilities, such as tennis courts, swimming pools, golf courses, etc., is taxable. Further, any amount paid by members for special use of the association's facilities, the use of which would not be available to all the members as a result of having paid the membership dues, fees, or assessments required to be paid by all members of the association, will be taxable. For example, if the membership dues, fees, or assessments do not entitle a member to use the association's party room or to use the swimming pool after a certain time period, then amounts paid for this use are taxable to the association.

Deductions from nonexempt income are allowed for expenses directly related to the production of such income, and a $100 deduction against taxable income is provided so that associations with only a minimal amount of taxable income will not be subject to tax. However, a net operating loss deduction is not allowed, and the special deductions for corporations (such as the dividends received deduction) are not allowed.

A homeowners association is taxed on its taxable income at the highest corporate rate (46 percent). If the association has net long-term capital gain, the tax rate is 28 percent for determining the association's alternative tax for capital gains.

Corporate tax rates

Under present law, a corporation is taxed at graduated rates on the first $100,000 of taxable income. The corporate rates are 17 percent on the first $25,000 of taxable income, 20 percent on the next $25,000, 30 percent on the next $25,000, 40 percent on the next $25,000, and 46 percent on all taxable income above $100,000. The alternative tax rate for capital gains is 28 percent.

The Code contains rules to prevent abuse of the graduated rate structure. A controlled group of corporations is limited in the aggregate to a maximum of $25,000 of taxable income in each of the rate brackets below the 46 percent bracket (Code sec. 1561). These rules are used to prevent income splitting by such commonly controlled corporations.

Issues

The issues are whether the taxable income of a homeowners association should be taxed at rates less than the highest corporate tax rate and, if so, what is the appropriate rate (or rates).

Explanation of the bill

The bill would provide that the taxable income of a homeowners association would be subject to the same graduated rates of tax as would a corporation's taxable income.

Effective date

The provisions of the bill would apply to taxable years beginning after December 31, 1978.

Revenue effect

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

Other possible issues for committee consideration

The committee may wish to consider the following issues related to the bill's proposal. The basic rationale for the tax treatment of homeowners associations in the Code is that activities which would not be taxed if engaged in by homeowners individually should not be subject to tax when the individuals band together in an association. An extension of this principle would appear to be that the rate of taxation on invested funds of the association should not greatly exceed the rate that would be imposed on the funds if they were invested by individual members of the association.

On the other hand, taxation of an association at the regular corporate rates would generally result in the taxation of this income at a rate of 17 percent. Members of homeowners associations are likely to be in higher tax brackets. In addition, there are apparently no rules which would prevent abuse of the graduated rate structure by commonly controlled or related homeowners associations. The tests for commonly controlled corporations would not appear to be effective in nonprofit corporations which do not normally have stock ownership. Also, as is the case with political organizations, there appear to be almost no barriers to prevent the multiplication of organizations in order to minimize the tax burden.

In addition, if the graduated rates are to apply, the committee may wish to consider whether the $100 deduction against taxable income should be repealed.

10. S. 2180—Senator Byrd (of Virginia)

Replacement Period for Nonrecognition of Gain on Sale of Residence

Present law

In general, the entire amount of gain realized on the sale of real property is recognized for income tax purposes. If certain requirements are met, however, gain on the sale of a taxpayer's principal residence will not be recognized, except to the extent the adjusted sales price of the old residence exceeds the cost of the new residence (Code sec. 1034).

To qualify for nonrecognition under section 1034, the taxpayer must purchase or construct, and use a replacement residence within certain time limits. The purchase of a new residence must occur within eighteen months before or after the sale of the old residence, and the taxpayer must use the new residence as a principal residence within eighteen months after the sale of the old residence (sec. 1034(a)). The construction of a new residence must begin no later than eighteen months after the sale of the old residence, and the taxpayer must occupy and use the new residence as his principal residence no later than two years after the sale of the old residence (sec. 1034(c)(5)).

Issue

The issue is whether the two-year time limit for the occupation of a newly constructed replacement residence should be extended to five years under limited circumstances.

Explanation of the bill

The bill would, under limited circumstances, require the Secretary of the Treasury to extend to five years the present two-year period during which a taxpayer must occupy and use as a principal residence a newly constructed replacement residence. The period would be extended only if a taxpayer: (1) sold his principal residence in 1977; (2) bought land for a new residence; (3) began construction of a replacement residence in 1977, which construction was terminated by the builder before completion; (4) suspended construction to preserve evidence against the builder; (5) sued and obtained a judgment against the builder; and (6) did not occupy the new residence within two years of the sale of the old residence because of the suspension of construction.

The bill is intended to benefit Mrs. Jane M. Cathcart of Virginia.

Effective date

The provisions of the bill would apply with respect to taxable years beginning after December 31, 1976, and before January 1, 1983.

Revenue effect

It is estimated that this bill will reduce budget receipts by less than $10,000 in fiscal year 1980 or 1981.

11. S. 2275—Senator Gravel

Technical Amendments to the Provisions Relating to General Stock Ownership Corporations

Present law

Under present law, a State is authorized to establish a general stock ownership corporation (GSOC) for the benefit of all its citizens. It is anticipated that the GSOC will be permitted to borrow money to invest in business enterprises. The cash flow from the operation of the business would be used to service and repay the loan, and the remaining cash would be distributed to the GSOC shareholders (i.e., all the citizens of the State).

Present law provides that a corporation must meet certain statutory tests in order to be treated as a GSOC. The GSOC's corporate charter must provide for the issuance of only one class of stock, the issuance of shares only to eligible individuals, and the issuance of at least one share to each eligible individual if such eligible individual does not elect within one year after the date of issuance not to receive such share. Also, the charter must provide for certain restrictions on the transferability of the GSOC shares. The transfer restriction must provide that the share cannot be transferred until the earliest to occur of (1) the expiration of five years from issuance, (2) death, or (3) failure to meet the State's residency requirements. In no event may shares of stock of a GSOC be transferred to nonresidents. Also, no person may acquire more than 10 shares of the GSOC's stock.

An eligible individual is any individual who is a resident of the chartering State as of the date specified in the enabling legislation and who remains a resident between that date and the date of issuance of the stock.

A GSOC must make an election to obtain special tax treatment. The effect of the election is to exempt the corporation from Federal income taxation. The shareholders of the GSOC would report their proportionate part of the GSOC's taxable income on their Federal individual income tax returns.

The GSOC computes its taxable income in the same manner as a regular corporation, with certain modifications. A GSOC is required to distribute 90 percent of its taxable income for any taxable year to its shareholders by January 31 of the next succeeding year. To the extent a GSOC fails to meet this distribution requirement, a tax equal to 20 percent of the deficiency (i.e., the difference between the required distribution and the actual distribution) is imposed on the GSOC.

Issues

One issue is whether, under the GSOC provisions, an estate could hold GSOC stock for distribution to a beneficiary. Another issue is whether the 20-percent tax on a deficiency (i.e., the difference between the required GSOC distribution and the actual GSOC distribution for a year) is deductible from the GSOC's taxable income for the year it is paid. The bill would make additional changes of a technical nature.

Explanation of the bill

Under the bill, an estate could be a shareholder of stock in a GSOC. The amendment would make clear that the 20-percent tax on a deficiency (i.e., the difference between the required GSOC distribution and the actual GSOC distribution for the year) would be deductible from the GSOC's taxable income for the year it is paid.

In addition, the bill would make several technical changes to the law governing GSOCs.

Effective date

The provisions of the bill would apply with respect to corporations chartered after December 31, 1978, and before January 1, 1984.

Revenue effect

This bill is not expected to have a direct effect on budget receipts.

B. HOUSE-PASSED BILLS

1. H.R. 4746: Miscellaneous Changes in the Tax Laws [1]

a. Simplification of private foundation return and reporting requirements (sec. 1 of the bill and secs. 6033, 6034, and 6056 of the Code)

Present law

Present law requires the foundation managers of private foundations having at least $5,000 of assets to file an annual report (sec. 6056). The report (Form 990–AR) is to contain the foundation's gross income, expenses, disbursements, balance sheet, total amount of contributions and gifts received by it during the year, an itemized list of all grants or contributions made or approved, the names and addresses of the foundation managers, and a list of those foundation managers who are substantial contributors or own certain interests in businesses in which the foundation owns an interest. This report must be made available for public inspection at the principal office of the foundation (sec. 6104(d)) and is open to public inspection at the offices of the Internal Revenue Service (sec. 6104(b)). In addition, the report must be furnished to the appropriate State officials (sec. 6056(d)).

Under present law, most exempt organizations described in section 501(c)(3) of the Code (including exempt private foundations) must file an annual information return (sec. 6033). Under this provision, the return for foundations, Form 990–PF, must state items of gross income, etc., and such other information as may be required by the forms and regulations. At present, this return contains most of the information required in the annual report of the foundation managers. This annual information return also is open to public inspection at the offices of the Internal Revenue Service (sec. 6104(b)). In addition, a copy of this return must be attached to the annual report of a private foundation when the report is furnished to the appropriate State officials (Treas. Reg. sec. 1.6056–1(b)(3)). Thus, information furnished on a foundation manager's report (Form 990–AR) substantially duplicates or overlaps the return filed by the foundation (Form 990–PF) in content and availability for public inspection.

Under present law, trusts which have solely charitable beneficiaries but which are not exempt from taxation (sec. 4947(a)(1) trusts) are subject to different return and disclosure requirements from those applicable to exempt charitable trusts and organizations. A nonexempt charitable trust is not required to file an annual information return open to public inspection. Instead, this type of trust is required to file an income tax return (Form 1041) under section 6012 if its

[1] This description is from the House Report on H.R. 4746 (H. Rept. No. 96–423).

gross income for the year is at least $600 or if it has any taxable income. (Form 1041 need not be filed by a nonexempt charitable trust which is a private foundation and which has no taxable income for the year.) These tax returns are not open to public inspection. In addition, a nonexempt charitable trust, other than one which is required to distribute all its net income currently, must file an annual information return (Form 1041–A), open to public inspection, setting forth certain information concerning its charitable contributions, income and expenses, and balance sheet items, but not containing all of the information required of exempt charitable trusts (sec. 6034). If a nonexempt charitable trust is a private foundation, it also must file a return (pursuant to the regulations under sec. 6011) setting forth much of the information contained on an exempt organization's information return, but this return (Form 5227) is not open to public inspection. In addition, a nonexempt charitable trust which is a private foundation must file the annual report (Form 990–AR or an equivalent report), which is open to inspection and must be furnished to the appropriate State officials as in the case of exempt private foundations, if the trust has at least $5,000 of assets.

Issues

One issue is whether the private foundation reporting requirements should be simplified by combining the annual return (Form 990–PF) and annual report (Form 990–AR) into a single annual return containing the information presently required on each of the two separate forms.

Another issue is whether nonexempt charitable trusts described in section 4947(a)(1) of the Code should be required to report the same information and be subject to the same disclosure requirements as exempt charitable organizations.

A further issue is whether the disclosure of the name and address of indigent or needy persons receiving grants of less than $1,000 in any year should no longer be required.

Explanation of provision

The bill eliminates the requirement (under sec. 6056) for the managers of any private foundation with assets of $5,000 or more to file an annual report. Instead, the bill requires that all information currently required to be furnished on the annual report (Form 990–AR) but not on the information return (Form 990–PF) be furnished instead on the foundation's annual information return (under sec. 6033). The combined annual information return will be subject to public inspection at the foundation's office and must be furnished to the appropriate State officials under the same conditions now applicable to the annual report.

In the case of a foundation which has no principal office or whose principal office is in a personal residence, it is anticipated that the Treasury will by regulation allow the annual inspection requirement to be met by having the return available for public inspection at an appropriate substitute location or by making copies of the return available by mail free of any charge (including postage and copying) upon request.

The bill also provides that the return not be required to contain the name and address of a needy or indigent recipient (other than a disqualified person) of a gift or grant made by the foundation where the total of the gifts or grants received by the person during the year from the foundation does not exceed $1,000.

The section 6033 information reporting requirements under the bill will apply to nonexempt charitable trusts described in section 4947 (a)(1) as well as to exempt charities. If a nonexempt charitable trust is a private foundation, the trust's information return must contain all the information required of an exempt private foundation. In addition, nonexempt trusts described in Code section 4947(a)(1) will no longer be required to file a Form 1041–A (under section 6034). In the case of a nonexempt charitable trust which has no taxable income, the Treasury may prescribe regulations to treat the filing of the information return as satisfying the income tax return filing requirements (under sec. 6012). The filing by a trust of the annual information return under section 6033, in good faith, showing sufficient facts upon which to determine income tax liability will commence the period of limitations on any income tax liability if it is later determined that the trust in fact had taxable income.[2]

Effective date

This provision would apply to taxable years beginning after December 31, 1979.

Revenue effect

This provision will not have any direct effect on budget receipts.

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[2] This rule is consistent with the principles of the decision in *California Thoroughbred Breeders Association* v. *Commissioner*, 47 T.C. 335 (1966), acquiesced in by the Commissioner in Rev. Rul. 69–247, 1969–1 CB 303, in which it was held that the filing of a Form 990 information return by an exempt organization disclosing sufficient facts to apprise the Service of potential unrelated business taxable income commenced the statute of limitations although a tax return (990–T) was not filed.

b. Treatment of payment or reimbursement by private foundations for expenses of foreign travel by government officials (sec. 2 of the bill and sec. 4941 (d)(2)(G) of the Code)

Present law

The Tax Reform Act of 1969 added to the Internal Revenue Code of 1954 a provision (sec. 4941) which in effect prohibits "self-dealing" acts between private foundations and certain designated classes of persons (referred to as "disqualified persons") by imposing a graduated series of excise taxes on the self-dealer (and also on any foundation manager who willfully and knowingly engages in the self-dealing). Under this provision, the payment or reimbursement by a private foundation of expenses of a government official [1] generally is classified as an act of self-dealing (sec. 4941 (d) (1) (F)).

A limited exception to this provision permits a private foundation to pay or reimburse certain expenses of government officials for travel solely within the United States (sec. 4941(d) (2) (G) (vii)). Under this exception, it is not an act of self-dealing for a private foundation to pay or reimburse a government official for actual transportation expenses, plus an amount for other traveling expenses not to exceed 1¼ times the maximum *per diem* allowed for like travel by U.S. Government employees. However, no such private foundation payment or reimbursement to government officials is permitted for travel to or from a point outside the United States.[2]

Issue

The issue is whether private foundations should be permitted to pay or reimburse government officials for expenses for foreign travel and, if so, under what circumstances.

Explanation of provision

The bill provides an additional exception to the self-dealing provisions of the Code (sec. 4941) for certain travel expenses of government officials. Travel expenses eligible for payment or reimbursement by a private foundation under this bill are those paid or incurred for travel between a point in the United States and a point outside the United States. The maximum amount which can be paid or reimbursed for any one trip by a government official is the sum of (1) the lesser of the actual cost of the transportation involved or $2,500, plus (2) an amount for all other traveling expenses not in excess of 1¼ times the

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[1] The term "government official" is defined in section 4946(c) as a person who holds a Federal elective office, a Presidential appointee to the executive or judicial branch, a Federal "super-grade" employee, a Congressional employee whose compensation is $15,000 a year or more, a State or local elective or appointive public officer whose compensation is $15,000 a year or more, or a personal or executive assistant or secretary to any of the above categories of persons. This bill does not affect that statutory definition of "government official."

[2] See, for example, Rev. Rul. 74–601, 1974–2 CB 385.

maximum amount payable under section 5702(a) of title 5, United States Code (relating to like travel by a U.S. government employee) for a maximum of 4 days.[3]

In cases where a trip takes fewer than 4 days, the maximum amount which can be paid or reimbursed for other traveling expenses is the maximum daily rate (i.e., 1¼ times the Federal *per diem*) times the number of days actually involved. In cases where a trip involves 4 or more days, the maximum amount of payment or reimbursement allowable is for 4 days.

In applying these limitations (both the $2,500 and the 4-day limitations), all parts of a trip are to be treated as a single trip. For example, assume that a government official travels from Washington to London for a conference which lasts 3 days. The official then travels from London to Tokyo for another conference that lasts 3 days. From Tokyo, the official returns to Washington. All three "legs" of the travel and both of the conference periods in this example are treated as constituting one continuing trip, which qualifies as travel between a point in the United States and a point outside the United States. The aggregate total costs of transportation from Washington to London, from London to Tokyo, and from Tokyo to Washington are subject to one $2,500 limitation, and the aggregate other traveling expenses in London and Tokyo are subject to one 4-day limitation.

The bill is to apply whether the eligible traveling expenses are advanced to the government official, are paid for directly by the private foundation, or are initially paid for by the government official and the private foundation reimburses the government official.

The committee expects that the travel would normally be in connection with a conference or similar meeting. However, the statutory provision is not limited to travel in connection with conferences or meetings. For example, the travel might be undertaken in connection with a fact-finding or research activity. Pursuant to section 4945(d)(5), a foundation can pay or reimburse eligible travel expenses of government officials only if such expenditures are for charitable, educational, or other exempt purposes specified in section 170(c)(2)(B). Thus, any payment or reimbursement by a private foundation of expenses of travel for nonexempt purposes (for example, travel for vacation purposes) would subject the foundation (and also any foundation manager who willfully and knowingly agrees to the making of the "taxable expenditure") to a graduated series of excise taxes based on section 4945.

The exception added by this bill is not available to a private foundation if more than one-half of the foundation's support (as defined in sec. 509(d)) is normally derived from any one business enterprise, any one trade association, or any one labor organization, whether such support takes the form of interest, dividends, other income, grants, or contributions. Accordingly, any payment or reimbursement by such a

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[3] Under 5 U.S.C. 5702(a), in the case of travel outside the continental United States, the President or his designee has the authority to establish the maximum *per diem* allowance for the locality where the travel is performed. As of August 1979, for example, 1¼ times the daily amount so established for travel expenses in London is $143.75; for travel in Paris; $112.50; and for travel in Tokyo, $121.25.

foundation to government officials for expenses of foreign travel cannot qualify under this new provision as an exception from self-dealing. For purposes of determining whether a private foundation's support is normally derived from any one business enterprise, trade association, or labor organization, "normal" support is to be determined by applying the rules set forth in Treasury Regulations issued under section 170(b)(1)(A)(vi) which define "normal" support in the case of organizations seeking to be classified as publicly supported charities (e.g., on the basis of a 4-year moving average in the case of organizations in existence for at least 5 years).

It is intended and expected that the Internal Revenue Service will advise the involved private foundation or government official, in response to a *bona fide* and properly filed request by the foundation or official, whether a proposed payment or reimbursement of travel expenses would qualify under this new exception (or under the existing exception applicable to domestic travel), so that neither the official nor any foundation manager will have to act at peril.[5]

Effective date

This provision would apply with respect to travel which begins after the date of enactment.

Revenue effect

It is estimated that these provisions will not have any direct revenue effect.

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[5] This bill does not affect the requirement of present law (sec. 4941(a)(1)) that an initial self-dealing excise tax is not to be imposed on a government official, as such, unless the official knows that the transaction constitutes an act of self-dealing. Notwithstanding this protection for officials who unknowingly participate in "self-dealing," a government official who is contemplating acceptance of foundation payment or reimbursement for travel expenses may wish to seek an advance ruling from the Service as to whether such payment or reimbursement qualifies under the existing exception for domestic travel or the exception made by the bill for foreign travel.

c. Alternative minimum tax on charitable lead trusts created by corporations (sec. 3 of the bill and sec. 57 of the Code)

Present law

The Revenue Act of 1978 imposed an alternative minimum tax with rates up to 25 percent on taxpayers other than corporations. Alternative minimum taxable income is gross income reduced by allowable deductions and increased by the amount of the taxpayer's adjusted itemized deductions and capital gains deduction. The preference for adjusted itemized deductions is generally the amount by which a taxpayer's itemized deductions (such as the charitable deduction) exceed 60 percent of the taxpayer's adjusted gross income. In general, the preference for adjusted itemized deductions was applied to charitable lead trusts (i.e., where the present interest in the trust is paid to the charity) in order that this type of trust could not be used to circumvent application of the alternative minimum tax to the grantor (or beneficiary) of the trust. Exceptions were provided where avoidance of the alternative minimum tax was not possible, e.g., estates, testamentary charitable lead trusts, and trusts created before 1978. However, no exception was provided for charitable lead trusts created by a corporation even though corporations are not subject to the alternative minimum tax. Consequently, the alternative minimum tax may be imposed on a charitable lead trust created by a corporation because the trust's charitable deduction for income paid to charity may give rise to the preference for adjusted itemized deductions.

Issue

The issue is whether an additional exception should be provided for charitable lead trusts where the grantor of the trust (and the owner of the reversionary interest in the trust) is a corporation.

Explanation of provision

The bill provides that the charitable contribution deduction of a charitable lead trust will not be treated as an itemized deduction in determining the adjusted itemized deduction preference for purposes of the alternative minimum tax if the grantor of the trust and the owner of all reversionary (or remainder) interests in the trust is a corporation.

Effective date

This provision would be effective for taxable years beginning December 31, 1975.[1]

Revenue effect

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

[1] The amendment would apply to all taxable years for which itemized deductions may be treated as a preference for minimum tax purposes. Preference treatment was first provided for certain itemized deductions under the Tax Reform Act of 1976.

d. Extension of withholding to payments of sick pay made by third parties (sec. 4 of the bill and secs. 3402 and 6051 of the Code)

Present law

Under present law (Code sec. 105(a)), amounts received by an employee through accident or health insurance for personal injuries or sickness (commonly referred to as wage continuation payments or "sick pay") generally must be included in gross income to the extent such amounts are attributable to contributions by the employer which were not includible in the gross income of the employee, or are paid by the employer.

Under section 3402(a) of the Code, every employer who makes wage payments is required to deduct and withhold income taxes from these payments. Payments made by an employer to an employee under a wage continuation plan generally are treated as wages and subject to withholding (except to the extent that an employee receives back contributions he or she previously made to a wage continuation plan). However, no tax is specifically required to be withheld upon any wage continuation payment made by a person who is not the employer for whom the employee performs services. Thus, for example, no tax is specifically required to be withheld from wage continuation payments made on behalf of an employer by an insurance company under an accident or health policy, by a separate trust under an accident or health plan, or by a State agency from a sickness and disability fund maintained under State law (Treas. Reg. sec. 31.3401(a)–1(b)(8)(ii)(*d*) and Announcement 77–117, 1977–32 IRB 24 (Aug. 8, 1977).)

Issue

The issue is whether an individual who receives "sick pay," which is not subject to withholding because it is paid by a third party, should be allowed to have tax withheld from such pay voluntarily.

Explanation of provision

In general

The bill amends section 3402(o) of the Code to specifically require withholding from sick pay, if the payee so requests. For purposes of this provision, sick pay would be defined as any amount which is paid to an employee pursuant to a plan to which the employer is a party, and which constitutes remuneration or a payment in lieu of remuneration for any period during which the employee is temporarily absent from work on account of sickness or personal injuries.

Under the bill, the amount of sick pay and annuity payments subject to withholding would be an amount specified by the payee in his or her request for withholding. However, in no case could this amount be less than a minimum amount to be set forth in regulations prescribed by the Secretary. In the case of a payment which is greater, or less, than a full payment, the amount withheld is to bear the same relation to the specified amount as such payment bears to a full payment.[1]

Requests for withholding

An individual who wishes to have his or her annuity or sick pay subject to withholding must make a written request to the person making the payments. This request must contain the individual's social security number and must specify the amount to be withheld from each full payment. In the case of sick pay, a request for withholding would be effective with respect to payments made more than 7 days after the date on which the request is furnished to the payor. In the case of an annuity, a request would be effective at such time (after the request is made) as the Secretary prescribes by regulations. A request for withholding may be changed or terminated by furnishing to the payor a written statement of change or termination.

Special rule for sick pay paid pursuant to collective-bargaining agreements

Under the bill, in the case of any sick pay paid pursuant to a collective-bargaining agreement between employee representatives and one or more employers, the amount of sick pay subject to withholding would be determined in accordance with such agreement if the agreement so provided. (That is, an employee who is a party to such an agreement would not be required to submit a written request for withholding to the payor.) However, there could be no withholding with respect to sick pay paid to an employee (who is party to a collective-bargaining agreement) who has in effect a withholding exemption certificate certifying that he incurred no tax liability for the preceding taxable year and anticipates that he will incur no tax liability for the current taxable year.

The special treatment accorded to collective-bargaining agreements would not apply to sick pay paid pursuant to such an agreement to any individual unless the individual's social security number is furnished to the payor and the payor is furnished with the information necessary to determine whether the payment is pursuant to the agreement and to determine the amount to be withheld.

Reporting requirement

The bill would require a person who makes a payment of third-party sick pay to an employee to furnish a written statement to the employer on behalf of whom the payment was made showing the name of the employee, the social security number of the employee (if there was withholding), the total amount of third-party sick pay paid to the employee during the calendar year, and the total amount (if any) withheld from sick pay. This statement would be due on or before January 15 of the year succeeding the year in which the payment of third-party sick pay was made. The bill defines "third-party sick pay" as any sick pay which does not constitute wages for purposes of withholding. This reporting

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[1] For example, assume an individual receives sick pay of $100 per week and requests $25 per week to be withheld for taxes. After four full weeks of absence, the individual returns to work on a Wednesday. For the week he returns to work, he would be entitled to $40 of sick pay, $10 of which would be withheld for taxes.

requirement would be in lieu of the reporting requirements of section 6041(a) relating to certain payments of $600 or more. In addition, the bill would provide that a person required to furnish a statement to an employer who willfully furnishes a false or fraudulent statement, or who willfully fails to furnish a statement in the manner, at the time, and showing the information required, would, for each such failure, be subject to a penalty of $50, and, upon conviction of each such offense, could be fined not more than $1,000, or imprisoned not more than one year, or both.

Every employer who receives a statement from a person who made a third-party payment of sick pay to an employee would be required to furnish the information to the employee on another statement which shows which portion (if any) of the sick pay is excludable from gross income and which portion is not excludable. This statement must be furnished to the employee on or before January 31 of the year succeeding the year in which the payment of third-party sick pay was made.

Effective date

This provision of the bill would apply to payments made on or after the first day of the first calendar month beginning more than 120 days after the date of enactment.

Revenue effect

It is estimated that this provision would cause a one-time increase in budget receipts of less than $5 million in fiscal year 1980.

e. Treatment of certain repayments of supplemental unemployment compensation benefits (sec. 5 of the bill and sec. 62 of the Code)

Present law

Under present law, workers who are laid off may become entitled to taxable supplemental unemployment compensation benefits [1] during periods for which they are laid off. Subsequently, they may receive trade readjustment assistance,[2] which generally is nontaxable (except to the extent otherwise provided in section 85 of the Code). When this occurs, those workers may be required to pay back the supplemental unemployment benefits they previously received.

If repayment is made by a worker, a deduction is allowable (under section 165 of the Code) for the repayment. In addition, a special relief provision, relating to the computation of tax where the taxpayer restores a substantial amount held under a claim of right, may apply (Code sec. 1341).

Under the special relief provision, if the worker pays back more than $3,000 of supplemental unemployment compensation benefits, income tax for the taxable year of repayment may be computed by claiming an itemized deduction for the repayment or, if a greater benefit is derived, the tax for the current year may be reduced by the amount of tax for the prior taxable year which was attributable to the inclusion of such benefits in gross income. However, this special tax computation is not available if the repayment does not exceed $3,000. In this case, no relief is available for the repayment of amounts previously included in gross income unless the worker claims itemized deductions for the taxable year in which the repayment is made.

Issue

The issue is whether workers who are required to repay supplemental unemployment compensation benefits because of the receipt of trade readjustment assistance should be allowed to claim a deduction from gross income in the year of repayment.

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[1] These benefits generally are paid by trusts exempt from taxation under Code sec. 501(c)(17) or by voluntary employees' beneficiary associations exempt from taxation under Code sec. 501(c)(9).

[2] Under the Trade Act of 1974, benefits are provided to workers who are separated from their jobs as a result of the adverse effect of increased imports. The worker's separation must be due to lack of work in adversely affected employment, and covered under a certification of eligibility. In the 52 weeks preceding his qualifying separation, he must have had at least 26 weeks of employment at wages of $30 or more a week in adversely affected employment with a single firm. Benefits under the Trade Act equal 70 percent of the worker's average weekly wage, but may not exceed the average weekly manufacturing wage. Benefits are reduced by 50 percent of any earnings during the week for which benefits are provided. These benefits generally are payable for up to 52 weeks, and also are provided in the form of training allowances, job search allowances, and relocation allowances.

Explanation of provision

The bill amends section 62 of the Code to allow a deduction from gross income for the repayment of supplemental unemployment compensation benefits if the repayment is required because of the receipt of trade readjustment allowances under sections 231 or 232 of the Trade Act of 1974. Qualifying repayments would be those made to trusts exempt from taxation under section 501(c)(17) of the Code or to voluntary employees' beneficiary associations exempt from taxation under section 501(c)(9) of the Code.

In the case of a repayment of more than $3,000 of supplemental unemployment compensation benefits, the taxpayer will continue to have the option of computing tax for the current taxable year under existing provisions for restoration of amounts held under a claim of right (Code sec. 1341).

Effective date

The provision would apply to repayments made in taxable years beginning after the date of enactment.

Revenue effect

It is estimated that this provision would reduce budget receipts by $5 million in fiscal year 1980 and in each year thereafter.

f. Disclosure of tax returns to State audit agencies (sec. 6 of the bill and sec. 6103(d) of the (Code)

Present law

Under present law (Code sec. 6103(d)), returns and return information may be disclosed to State agencies which are charged under the laws of the State with responsibility for the administration of State tax laws for the purpose of, and only to the extent necessary in, the administration of such laws. Section 6103(d) sets forth specific rules with which a State agency must comply in order to receive Federal tax information. For example, the request for disclosure must be made by the head of the State tax agency in writing and the actual disclosure of the tax information may be made only to the representatives of the State tax agency who are designated in the written request to receive the information. Also, the law provides that the tax information cannot be disclosed to the Governor of a State. In addition, return information may not be disclosed to the extent that the Secretary of the Treasury determines such disclosure would identify a confidential informant or seriously impair any civil or criminal tax investigation.

Return information disclosed to State agencies is subject to strict safeguard, recordkeeping, and reporting requirements (Code secs. 6103(p)(3) and 6103(p)(4)). These requirements provide assurances that Federal tax return information will be used only for the purposes authorized by law and provide a basis for determining when violations occur.

Present law allows State auditing agencies access to Federal tax return information only when the auditing agency actually is involved in the determination, assessment, collection, or refunding of taxes (that is, tax administration activities). Thus, a State auditing agency is not authorized access to Federal tax return information when the auditing agency's role is limited to general oversight of the taxing authority.

Issue

The issue is whether State taxing authorities should be permitted to disclose Federal tax return information in their possession to State auditing agencies for the purpose of auditing the activities of the State tax authority.

Explanation of provision

The bill provides that any returns or return information obtained by a State agency pursuant to the provisions of section 6103(d) may be open to inspection by, or disclosure to, officers and employees of the State audit agency for the purpose of, and only to the extent necessary in, making an audit of the State agency which obtained the returns or return information. Under the bill, a "State audit agency" is defined as any State agency, body, or commission which is charged under the laws of the State with the responsibility of auditing State revenues and programs.

In addition, a State audit agency which receives return information would be subject to the same safeguard, recordkeeping, and reporting requirements as apply to other State agencies which receive return information and would be subject to the confidentiality requirements imposed by section 6103(a) and the civil and criminal penalties applicable in the case of unauthorized disclosure of such return information.

Effective date

This provision would become effective upon enactment.

Revenue effect

This provision will not have any impact on Federal revenues.

g. Investment tax credit for certain property used in maritime satellite communications (sec. 7 of the bill and sec. 48 of the Code)

Present law

Under present law, a credit against tax liability is provided with respect to a taxpayer's investment in certain types of depreciable business assets. Generally, the investment credit rate is 10 percent of qualified investment. Qualifying property for purposes of this investment tax credit includes tangible personal property and other tangible property used as an integral part of certain activities, including the furnishing of communications services. However, property which otherwise qualifies will generally be excluded from the credit if it is used predominantly outside of the United States or is used by a governmental unit or an international organization.

Under provisions enacted in the Revenue Act of 1971, these exclusions are made inapplicable to any interest of a United States person in communications satellites and property used by the International Telecommunications Satellite Organization (INTELSAT), an international joint venture established to develop and operate the space segment of the global commercial communications satellite system. As a result, the Communications Satellite Corporation (COMSAT) is entitled to the credit for its investments in the INTELSAT system. COMSAT, a private, for-profit corporation created pursuant to the Communications Satellite Act of 1962, is the designated United States participant in INTELSAT.

During the 95th Congress, the International Maritime Satellite Telecommunications Act (P.L. 95-564) amended the Communications Satellite Act of 1962 to designate COMSAT as the United States participant in the International Maritime Satellite Organization (INMARSAT). INMARSAT is an international organization, similar in structure and operation to INTELSAT, which is being established to develop and operate a global maritime satellite telecommunications system.

Issue

The issue is whether investments in property used by INMARSAT should be eligible for the investment tax credit.

Explanation of provision

This provision of the bill will make the international organization exclusion under the investment tax credit inapplicable to property used by the International Maritime Satellite Organization (INMARSAT). As a result, the investment tax credit will be available for investments by COMSAT or other United States persons in property owned or used by INMARSAT. This is the same treatment as was provided in 1971 for investments in the INTELSAT system.

Effective date

This provision would apply to taxable years beginning after December 31, 1979.

Revenue effect

It is estimated that this provision would have an insignificant effect on budget receipts through fiscal year 1984.

h. Increases in interest rates payable on United States retirement plan and individual retirement bonds (sec. 8 of the bill and sec. 1 of the Second Liberty Bond Act (31 U.S.C. 752))

Present law

Under present law, a person eligible to establish an individual retirement account may purchase retirement bonds issued for this purpose by the Treasury Department. These bonds are not transferable and are subject to many of the restrictions that apply to individual retirement accounts. Retirement plan bonds are issued for H.R. 10 plans established by self-employed persons and for retirement and annuity plans established by employers for their employees. The interest rate on any such retirement bonds remains unchanged throughout its life.

By contrast, the interest rates on issued Series E savings bonds are increased whenever there is an increase in the interest rates on new issues of Series E bonds. This adjustment is made in recognition of the holder's ability to redeem the outstanding bond before maturity and to reinvest the proceeds in new Series E bonds issued with the higher interest rate.

Issue

Absent any provision authorizing adjustments in the interest rate for outstanding U.S. retirement bonds, potential purchasers may be expected to turn to various retirement plan arrangements offered in the private sector. Any net reduction in Treasury Department sales of retirement bonds will increase the amount of money that must be raised by the Treasury Department in some other manner.

The issue is whether the Treasury Department should be authorized to adjust upward the interest rate paid on outstanding retirement bonds.

Explanation of provision

The bill permits the investment yield (which term is used as identical to the interest rate) on U.S. retirement plan bonds (sec. 405 (b)) and U.S. individual retirement bonds (sec. 409(a)) to be increased for any interest accrual period so that the investment yield for that accrual period on the bonds is consistent with the investment yield for the accrual period on Series E savings bonds.

Any increased interest rates, and the accrual periods to which these rates apply, are to be specified in regulations to be issued by the Treasury Department. The bill provides that these regulations, to be effective, must be approved by the President.

Effective date

This provision would apply to interest accrual periods that begin after September 30, 1977, with respect to bonds issued before, on, or after the date of enactment, but only for the purposes of increasing the investment yield on such bonds for interest accrual periods which begin after the date of enactment.

Revenue effect

It is estimated that this provision would have no effect on budget receipts, but it will increase outlays by $6 million in fiscal 1980 and by $2 million each year thereafter.

2. H.R. 5505: Tax Administrative Provisions Revision Act of 1979 [1]

a. Change of time for paying excise tax on fishing equipment (sec. 7 of the bill and sec. 4161(a) of the Code)[2]

Present law

Under present law (Code sec. 4161(a)), there is imposed upon the sale of fishing rods, creels, reels, and artificial lures, baits, and flies (including parts or accessories of such articles sold on or in connection therewith, or with the sale thereof) by the manufacturer, producer, or importer a tax of 10 percent of the price for which the article is sold.

Treasury Department regulations prescribing the time for making deposits of manufacturers excise taxes are found in Treas. Reg. sec. 48.6302(c)–1. If an individual is liable in any month for more than $100 of taxes reportable on Form 720 (Quarterly Excise Return) and he is not required to make semimonthly deposits, the individual must deposit the amount on or before the last day of the next month at an authorized depository or at the Federal Reserve Bank serving the area in which the individual is located. If an individual had more than $2,000 in excise tax liability for any month of a preceding calendar quarter, he must deposit such taxes for the following quarter (regardless of amount) on a semimonthly basis. The taxes must be deposited by the ninth day following the semimonthly period for which they are reported. In addition, if the semimonthly period is in either of the first two months of the quarter, any underpayment of excise taxes for a month must be deposited by the ninth day of the second month following such month. Underpayments in the third month of the quarter must be deposited by the end of the following month.

No special rules are provided to defer payment of the excise tax with respect to sales of taxable articles on credit except certain installment sales.

Issue

The issue is whether the payment of excise taxes imposed upon the sale of fishing equipment should be postponed in order to match more closely the collection of sales' proceeds by the manufacturer, producer, or importer.

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[1] Provisions relating to the simplification of certain procedure rules (secs. 2–6 of the bill) and extension of expiring tax provisions (sec. 12 of the bill) were enacted as part of Public Law 96–167 (H.R. 5224) in 1979. This description is from the House Report on H.R. 5505 (H. Rept. No. 96–545).

[2] Provisions which are identical to this section of the bill are also contained in H.R. 1212, as reported by the Senate Finance Committee (S. Rept. No. 96-532, sec. 403). Also, a hearing was held on S. 1549, which contains the same provisions, by the Finance Subcommittee on Taxation and Debt Management Generally on November 7, 1979.

Explanation of provision

The bill provides that the manufacturers excise tax imposed on the sale of fishing equipment is payable according to the following schedule:

For articles sold during the quarter ending:	*Payment of the tax is due by:*
December 31	March 31
March 31	June 30
June 30	September 24
September 30	According to Treasury Regulations

In the case of sales of fishing equipment made during the first two quarters of the Federal fiscal year, the bill extends the due date for payment for up to 5 months and 1 week beyond that applicable under present law. In the case of sales made during the third such quarter (ending June 30), the extension is not as long (until September 24), in order to insure that all payments for sales made through June 30 are included in Federal Government receipts for the fiscal year, which ends on September 30.

In the case of sales made during the fourth such quarter, the bill does not require any change from the payment schedule presently in effect under Treasury regulations (sec. 48.6302(c)–1). However, the bill does not preclude the Secretary of the Treasury from changing such regulations, to the extent the Secretary from time to time may deem appropriate, with respect to the due date for payment of excise taxes incurred on sales of fishing equipment made during the quarter ending September 30.

Effective date

The provision would apply to excise taxes payable on fishing equipment sold on or after the first day of the first calendar quarter beginning after the date of enactment of the bill.

Revenue effect

This provision would not affect the aggregate fiscal year receipts of the manufacturers excise tax on fishing equipment.

b. Excise tax treatment of domestic wines for certain uses (sec. 8 of the bill and sec. 5362 of the Code)

Present law

Under present law, both imported wines and those produced in the United States are generally subject to the same excise taxes (Code sec. 5041). Domestically produced wines may be withdrawn from bonded wine cellars without payment of tax for certain purposes, including exportation, use on certain vessels and aircraft, and further processing in a customs manufacturing warehouse prior to exportation (Code sec. 5362(c)). In addition, domestic wines on which the tax has been paid or determined may be transferred for these purposes and the authorized person may receive repayment of the tax by way of drawback.

Present law allows foreign wines to be imported into the United States and sold tax-free from customs bonded warehouses for uses such as supplies on certain vessels and aircraft and the official or family use, in the United States, of foreign governments, public international organizations, and certain individuals associated with these governments and organizations. In contrast, domestic wines may not be transferred without payment of tax to customs bonded warehouses, other than manufacturing warehouses, and there is no provision which authorizes the tax-free withdrawal of domestic wines from a bonded winery for the use of certain foreign governments and related individuals. While present law permits the tax-free withdrawal from internal revenue bond of domestically produced wine for the use of certain vessels and aircraft, there is no provision authorizing the tax-free transfers of wine to a customs bonded warehouse for storage pending removal as vessel or aircraft supplies. As a result, it is presently necessary for domestic wines to be exported and then returned to a customs bonded warehouse in the United States in order for sales of these wines to be made without payment of tax to foreign embassies, legations, international organizations, and related individuals, or to accomplish a tax-free transfer of domestic wines to a customs bonded warehouse prior to the authorized withdrawal for use as supplies by certain vessels or aircraft.

The same difference in treatment had previously existed for distilled spirits, which are generally subject to separate taxing provisions. This difference was resolved for distilled spirits under legislation enacted in 1971[1] and 1977[2] so that distilled spirits may be transferred, without payment of tax, to customs bonded warehouses located in the United States and held free of tax for exempt sales, such as those to foreign governments and international organizations (and related individuals) and for certain ship and aircraft supplies. The 1971 amend-

[1] P.L. 91-659, enacted January 8, 1971.
[2] P.L. 95-176, enacted November 14, 1977.

ments also included provisions to prevent the resale or unauthorized use of distilled spirits which are sold tax-free to foreign governments, international organizations, and related individuals (Code sec. 5066).

Issue

The issue is whether domestic wines should be accorded the same treatment as imported wines by allowing domestic wines to be transferred without payment of excise tax to customs bonded warehouses for purposes of tax-exempt sales.

Explanation of provision

The bill would allow the transfer of wine without payment of excise tax to any customs bonded warehouse rather than allowing transfers only to customs manufacturing warehouses, as under present law. In addition, the bill specifies that wine entered into customs bonded warehouses may be withdrawn tax-free for consumption in the United States by and for the use of foreign governments, organizations, and related individuals, and the same prohibitions relating to the resale or unauthorized use of distilled spirits will apply to these transfers of wine. As a result, the same treatment would be accorded wine as is provided for distilled spirits under present law so that domestic wine may be sold tax-free from customs bonded warehouses for qualifying ships and aircraft supplies and for the use of foreign embassies, legations and related individuals.

Effective date

The provisions would be effective on the first day of the first calendar month which begins more than 90 days after enactment.

Revenue effect

It is estimated that the provisions would have a negligible effect upon budget receipts.

c. Refunds of tread rubber excise tax (sec. 9 of the bill and secs. 4071, 6416, and 6511 of the Code)

Present law

Present law imposes a tax of 5 cents per pound on tread rubber used for recapping or retreading tires of the type used on highway vehicles (secs. 4071(a)(4), 4072(b), and 4073(c)).[1]

Tread rubber may be sold tax-free for use otherwise than in the recapping or retreading of tires of the type used on highway vehicles, or a credit or refund (without interest) of the tread rubber tax may be obtained if the tax-paid tread rubber is used or sold for use otherwise than in the recapping or retreading of tires of the type used on highway vehicles (sec. 6416(b)(2)(G)).

There are several instances under present law where a manufacturers excise tax is imposed on tread rubber when in a similar situation the manufacturers excise tax is not imposed (or a credit or refund of the tax is allowed) on new tires.

First, rubber wasted in manufacturing new tires is not subject to tax since the tax is imposed when the completed tire is sold and only upon the material actually contained in the completed tire. The tax on tread rubber, on the other hand, is imposed before the recapping or retreading of a used tire. Wastage of tread rubber in that process occurs after the tread rubber tax liability has been determined, and under present law no refund or credit is provided for any portion of the tax imposed on tread rubber which is so wasted.[2]

Second, if the sale price of a retreaded tire is adjusted by reason of a warranty or guarantee, no credit or refund of the tread rubber tax is provided.[3]

Third, no credit or refund is available for the tread rubber tax when a recapped or retreaded tire is exported, sold to a State or local government, sold to a nonprofit educational organization, or used or sold for use as supplies for vessels or aircraft (secs. 4221 and 6416(b)).

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[1] The tax on tread rubber is scheduled to expire on October 1, 1984 (sec. 4071(d)(3)), (Revenues from this tax go into the Highway Trust Fund.)

[2] In *Great Olympic Tire Co.* v. *U.S.*, 597 F.2 449, 78–1 USTC ¶ 16,316 (5th Cir. 1979), the Fifth Circuit Court of Appeals held that tread rubber wasted in the recapping process is not subject to the section 4071(a)(4) manufacturers excise tax, and that highway-type tires returned under warranty after partial use are subject to the tax without allowance for a refund or credit of the tax previously imposed on the tread rubber remaining on the returned tire. In arriving at these conclusions, the court relied upon the fact that wasted rubber never became part of tires of the type used on highway vehicles and that rubber remaining in a returned tire had become part of a tire of the type used on highway vehicles. While the section 4071(a)(4) tread rubber tax does not refer to highway-type vehicle tires, as does the section 4071(a)(1) new tire tax, the court noted that the legislative history of the tread rubber tax clearly evidences an intention to limit the tax to such tires. *See*. H. Rept. No. 10660, 84th Cong., 2d Sess., 1956–2 C.B. 1312; Rev. Rul. 65–223, 1965–2 C.B. 420.

[3] *See* note 2, *supra*.

Neither is the credit or refund available where a retreaded tire is mounted on a new vehicle that then is disposed of in any of the above ways.

While used and recapped or retreaded tires ordinarily are subject to the tire tax when imported, a different situation exists when a used tire which has been taxed in the United States is exported, is retreaded (other than from bead to bead) abroad, and then is shipped back into the United States.[4] Then there is neither a tax on the imported retreaded tire nor on the tread rubber used in the retreading, because the tire already has been taxed and the tread rubber is considered to have lost its identity.

Under present law, the general time by which a claim for credit or refund of a tax must be filed is 3 years from the time the tax return was filed or, if later, 2 years from the time the tax was paid (sec. 6511).

Issues

Several issues are presented by the bill:

(1) whether a credit or refund of the tread rubber tax should be available in those instances where a credit or refund of the similar manufacturers excise tax on new tires would be available;

(2) whether the manufacturers excise tax on tread rubber should be imposed where a tire has been exported for recapping outside the United States and subsequently is imported into the United States; and

(3) whether the statute of limitations for claiming a credit or refund of the manufacturers excise tax on tread rubber should be extended where a claim for credit or refund of the tread rubber tax is filed as a result of a warranty or guarantee adjustment.

Explanation of provisions

Credit or refund of tread rubber tax

This provision of the bill makes a credit or refund of the tread rubber tax available in three situations. These changes are intended to permit a credit or refund of the tax on the tread rubber used on a recapped or retreaded tire, under the same circumstances where a credit or refund would be available for the tax on a new tire.

First, the credit or refund would be available where rubber is destroyed, scrapped, wasted, or rendered useless in the recapping or retreading process.

Second, the credit or refund would be available where the tread rubber is used in the recapping or retreading of a tire if the sales price of the tire is later adjusted because of a warranty or guaranty. The overpayment (that is, the amount available for credit or refund) would be the same proportion of the tax paid as the adjustment in the sales price of the retreaded tire to the immediate vendee by the tire retreader.

Third, a credit or refund of the tread rubber tax would be available to the manufacturer for the tread rubber on a recapped or retreaded tire if the tire is by any person (1) exported, (2) sold to a State or local government for its exclusive use, (3) sold to a nonprofit educa-

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[4] Tires recapped from bead to bead are considered as having been newly manufactured and thus are taxable.

tional organization for its exclusive use, or (4) used or sold for use as supplies for a vessel or aircraft.

Finally, where a retreaded tire is sold by the retreader or by another manufacturer on or in conjunction with another article (for example, a truck) manufactured by it, the bill would provide that a credit or refund of the tread rubber tax is to be allowed to the manufacturer of the other article if the article is exported or sold by any person for any of the above purposes.

Tax on imported recapped or retreaded tires

The provision also would provide that used tires which are exported from the United States, recapped or retreaded abroad (other than from bead to bead), and then imported into the United States are to be subject to the tax on tread rubber. For this purpose, the amount of tread rubber to be taken into account is to be determined as of the completion of the recapping or retreading of the tire. The amount so determined would be either the amount which is established as actually used in recapping or retreading the tire or an average amount which is generally used on comparable tires in the industry, as determined by the Treasury Department (sec. 4701(c)).

If a retreaded tire is imported on a vehicle which is not itself subject to a manufacturers excise tax (e.g., a passenger car or a light-duty truck), then the importer of the vehicle is under existing law (Code sec. 4071(e)) treated as the importer of the tire. However, as noted, if the tire is not taxable because it was exported and recapped abroad (except from bead to bead), the importer is not liable for tax on the tread rubber on the imported tire. This provision carries the process a step further and would treat the importer of the vehicle as the importer of the tread rubber that is on a retreaded tire which is not otherwise subject to tax on the complete tire. Thus, the tread rubber would be subject to tax.

Warranty or guaranty adjustments

The provision also would modify the statute of limitations in cases where a claim for credit or refund of the tread rubber tax is filed as a result of a warranty or guaranty adjustment. The amendment provides that in such a case a claim for credit or refund may be filed at any time before the date which is one year after the date on which the adjustment is made, if the period for filing the claim would otherwise expire before that later date.

In other words, under this provision, the manufacturer would be assured that it will have one day less than a year after the time the adjustment is made (or deemed made) within which to file a claim for credit or refund of the relevant tax.

Effective date

This provision would be effective on the first day of the first calendar month which begins more than 10 days after the date of the provision's enactment.

Revenue effect

It is estimated that this provision would reduce budget receipts by less than $100,000 in fiscal year 1980, and by less than $200,000 annually during each of the next 4 fiscal years. (These amounts would otherwise go into the Highway Trust Fund—through September 30, 1984.)

d. Nonrecognition of gain on sale of residence for certain members of the Armed Forces (sec. 10 of the bill and sec. 1034 of the Code)

Present law

Under present law, the entire amount of gain or loss realized on the sale or exchange of property generally is recognized. However, under a "rollover" provision of the Code (sec. 1034), gain is not recognized on the sale or exchange of a taxpayer's principal residence if a new principal residence, at least equal in cost to the adjusted sales price of the old residence, is purchased and used by the taxpayer as his or her principal residence within a period beginning 18 months before and ending 18 months after the date of the sale of the old residence. The basis of the new residence then is reduced by the amount of gain not recognized on the sale of the old residence.

The replacement period is suspended during any time that the taxpayer (or the taxpayer's spouse) serves on extended active duty with the Armed Forces of the United States after the date of the sale of the old residence. Currently, this suspension may not extend more than four years beyond the date of the sale of the old residence. Thus, a member of the Armed Forces generally is not required to recognize gain on the sale of a principal residence if he or she purchases and uses a new principal residence within four years after the date of the sale of the old residence.

Issue

The issue is whether the period of time in which a new principal residence may be purchased, in order to qualify for nonrecognition of gain on the sale of the old principal residence, should be extended in the case of a member of the Armed Forces who is stationed outside of the United States or is required to reside in Government-owned quarters.

Explanation of provision

This provision extends the period of time in which a member of the Armed Forces who is stationed outside of the United States or is required to reside in Government-owned quarters must purchase a new principal residence in order to qualify for nonrecognition of gain on the sale of the old principal residence. Under this provision, a member of the Armed Forces who is stationed outside of the United States or is required to reside in Government-owned quarters after the date of the sale of the principal residence generally will not recognize gain on the sale of the residence if the taxpayer purchases and uses a new principal residence within the later of four years after the date of the sale of the old residence or one year after the date on which the taxpayer is no longer stationed outside of the United States or is no longer required to reside in Government-owned quarters.

The benefits of this additional extension period will be available only if the taxpayer has timely filed, with the Internal Revenue Service, a notice of the taxpayer's intent to take advantage of the extension.

The extension of the period for replacement of a residence by a member of the Armed Forces was not intended to constitute a precedent for providing similar rules for other taxpayers because the problem of replacing a principal residence beyond the usual 18-month period by a member of the Armed Forces was considered to be a unique problem.

Effective date

The provision would apply to sales of old residences after December 31, 1979 by eligible members of the Armed Forces.

Revenue effect

This section would have no effect on budget receipts through fiscal year 1985. Beginning with fiscal year 1986, it its estimated that this program will reduce budget receipts by $10 million annually .

e. Exempt status of auxiliaries of certain fraternal beneficiary societies (sec. 11 of the bill and sec. 501 of the Code)

Present law

Under present law, social clubs and similar nonprofit organizations, such as national organizations of college fraternities and sororities, are exempt organizations. Code section 501(c)(7) provides that these organizations must be organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes with no part of the net earnings inuring to the benefit of any private shareholder.

However, section 501(i) provides that an organization otherwise exempt from income tax as an organization described in section 501(c)(7) is to lose its exempt status for any taxable year, if at any time during that year the organization's charter, by-laws or other governing instrument, or any written policy statement, contains a provision which provides for discrimination against any person on the basis of race, color, or religion.

Exempt status is granted under section 501(c)(8) to fraternal beneficiary societies, orders, or associations which operate under the lodge system or for the exclusive benefit of the members of a fraternity operating under the lodge system, and which provide for the payment of life, sick, accident, or other benefits to the members of the society, order, or association, or their dependents.

Issue

The issue is whether exempt status under section 501(c)(7) should be provided for auxiliaries of a fraternal beneficiary society which is exempt under section 501(c)(8) and which limits its membership to members of a particular region.

Explanation of provision [5]

This provision allows certain auxiliaries of fraternal beneficiary societies to qualify for tax-exempt status under section 501(c)(7) even though membership in the auxiliaries is limited to members of a particular religion. The bill provides that the restriction on religious discrimination in section 501(i) shall not apply to an auxiliary of a fraternal beneficiary society if the society is described in section 501(c)(8), is exempt from income tax under section 501(a), and limits its membership to the members of a particular religion.

The intended beneficiaries of this provision are the affiliated corporations of the unincorporated, subordinate lodges of the Knights of Columbus, a fraternal society which claims tax-exempt status under section 501(c)(8). Generally, these affiliated corporations were formed to hold title to real property. Prior to the enactment of section 501(i) in 1976, some of the Knights' affiliated corporations have been treated as social clubs described in section 501(c)(7).

Effective date

The provision would apply to taxable years beginning after October 20, 1976, the date on which section 501(i) of the Code became effective.

Revenue effect

It is estimated that this provision would result in a negligible reduction in budget receipts.

3. H.R. 5973: Tax Treatment of Certain Individuals Living Abroad and Certain Pension Plan Distributions[1]

a. Waiver of time limits in foreign residence or presence requirement for Americans working abroad (sec. 1 of the bill and sec. 913 of the Code)[2]

Present law

Prior to enactment of the Foreign Earned Income Act of 1978, an American who was present in a foreign country or countries for at least 510 full days during any period of 18 consecutive months, or who was a *bona fide* resident of a foreign country or countries for an uninterrupted period which included an entire taxable year, was entitled to exclude up to a flat amount (generally $20,000) per year of his foreign earned income (sec. 911).

The 1978 Act retained these eligibility requirements but changed the special provisions for Americans working abroad. Generally, qualifying individuals are allowed a deduction for their excess foreign costs of living. The new excess living cost deduction (new sec. 913) consists of separate elements for the general cost of living, housing, education, and home leave costs. In addition, taxpayers living and working in certain hardship areas are allowed a special $5,000 deduction in order to compensate them for the hardships involved and to encourage U.S. citizens to accept employment in these areas. As an exception to these new rules, the Act permits employees who reside in camps in hardship areas to elect to claim a $20,000 earned income exclusion (under sec. 911) in lieu of the new excess living cost and hardship area deductions. As noted above, the foreign presence or residence criteria of prior law continue to determine whether or not Americans working abroad qualify for the special deduction or exclusion.

If a taxpayer working abroad is "temporarily" away from home in pursuit of a trade or business, the taxpayer generally may deduct traveling expenses (including amounts spent for meals and lodging) for himself but generally not for family members who accompany him. The taxpayer's "home" for this purpose is generally his principal place of employment. While a determination of whether the taxpayer is "temporarily" away from home depends on all the facts and circumstances, the Internal Revenue Service often holds that the taxpayer is "temporarily" away from home if his employment is not anticipated to,

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[1] This description is from the House Report on H.R. 5973 (H. Rept. 96–689).

[2] In principle, this provision was approved by the Senate Finance Committee on December 6, 1979. The Subcommittee on Taxation and Debt Management Generally held a hearing on S. 873, which contains similar provisions on November 7, 1979.

and does not actually, last more than a year. Otherwise, the Service ordinarily views the taxpayer as not being temporarily away from home and not entitled to these deductions.[3] A number of items in the deduction for excess foreign living costs are measured with reference to the location of the individual's tax home.

Issue

The issue is whether, in a case where an individual goes abroad with the expectation of meeting the foreign residence or presence requirements, but fails to meet those requirements because of extraordinary circumstances beyond his control, relief should be afforded from the time limitations.

Because of the recent civil unrest in Iran, a number of Americans who were working there with the expectation of meeting the foreign residence or presence requirements returned to the United States prior to the time that those requirements actually were met.

Explanation of provision

This provision would provide that, under certain circumstances, the time limits of the foreign residence or presence eligibility requirements for the deduction for excess foreign living costs or the exclusion for foreign earned income may be waived. Three conditions must be met for the waiver to apply. First, the individual actually must have been a *bona fide* resident of, or present in, a foreign country. Second, he must leave the foreign country after August 31, 1978, during a period with respect to which the Treasury Department determines, after consultation with the State Department, that individuals were required to leave the foreign country because of war, civil unrest, or similar adverse conditions in the foreign country which precluded the normal conduct of business by those individuals. It is anticipated, for example, that such determinations ordinarily would be made in situations where the State Department issues a travel advisory recommending that U.S. citizens avoid travel to a country because of unsettled conditions there. Third, the individual must establish to the satisfaction of the Treasury that he could reasonably have been expected to meet the time limitation requirements, but for the war, civil unrest, or similar adverse conditions. An individual who could reasonably have been expected to be present in a foreign country for a period of 17 out of 18 months or a *bona fide* resident of that country for an entire taxable year would be considered to have his tax home in that country for purposes of the excess living cost deduction rather than being considered to be temporarily present in that country. If these criteria are met, the taxpayer would be treated as having met the foreign residence or presence requirements with respect to the period during which he was a *bona fide* resident or was present in the foreign country even though the relevant time limitation under existing law had not been met.

Effective date

With respect to the deduction for excess foreign living costs and the $20,000 annual exclusion as amended by the Foreign Earned Income Act of 1978, the provision would apply to taxable years beginning after

[3] Rev. Rul, 60-189, 1960—1 C.B. 60.

December 31, 1977 (the general effective date for those provisions). Similar rules also are to be applied for taxable years beginning in 1977 or 1978 in the case of individuals who would otherwise be eligible for the exclusion of foreign earned income (sec. 911) as in effect prior to the 1978 Act, including taxpayers who, for 1978, elect the exclusion as amended by the Tax Reform Act of 1976.

Revenue effect

This provision would have no effect upon budget receipts. It forgives an unanticipated one-time tax increase of $10 million in fiscal year 1980.

b. Special rule for certain distributions from money purchase pension plans (sec. 2 of the bill and sec. 402 of the Code)

Present law

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

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

Issue

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

Explanation of provision [2]

This provision would allow an employee who receives a total distribution from a money purchase pension plan (which is otherwise eligible for taxfree rollover treatment) to roll over the distribution to an IRA or to another qualified plan where the employer also maintains a defined benefit pension plan covering the employee even though a total distribution is not made from the defined benefit plan in the same taxable year. The provision also would apply to the spouse of an employee if the spouse receives such a total distribution on account of the employee's death.

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[1] A rollover to a plan is not permitted if any part of the lump sum distribution represents contributions made while the employee was self-employed.

[2] An identical provision is contained in H.R. 1212, as reported by the Senate Finance Committee (S. Rept. No. 96–532, sec. 405).

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

Effective date

Generally, this provision would apply to payments made in taxable years beginning after December 31, 1978. In the case of such payments made before January 1, 1981, the period for making a rollover would not expire before December 31, 1980.

Revenue effect

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

c. Definition of youth participating in a qualified cooperative education program for purposes of the targeted jobs credit (sec. 3 of the bill and sec. 51(d)(8) of the Code)

Present law

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

Issue

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

Explanation of provision [1]

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

Effective date

This provision would apply with respect to wages paid on or after November 27, 1979, in taxable years ending on or after such date.

Revenue effect

It is estimated that this provision would reduce fiscal year 1980 budget receipts by less than $1 million, by less than $5 million annually in fiscal years 1981 and 1982, and by less than $1 million in fiscal year 1983.

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[1] An identical provision is contained in H.R. 2797, the Technical Corrections Act of 1979, as reported by the Senate Finance Committee (S. Rept. No. 96–498, sec. 103(a)(6)(F)).

d. Special rule relating to debt-financed income of exempt organizations (sec. 4 of the bill)

Present law

Generally, any organization which is exempt from Federal income tax (under sec. 501(a)) is taxed only on income from trades or businesses which are unrelated to the organization's exempt purposes; it is not taxed on passive investment income or income from any trade or business which is related to the organization's exempt purposes.[1]

Before 1969, some exempt organizations had used their tax-exempt status to acquire businesses through debt financing, with purchase money obligations to be repaid out of tax-exempt profits, for example, as from leasing the assets of acquired businesses to the businesses' former owners.

The Tax Reform Act of 1969 provided (in the so-called "Clay Brown provision") that an exempt organization's income from "debt-financed property," which is not used for its exempt function, is to be subject to tax in the proportion in which the property is financed by debt. In general, debt-financed property is defined as "any property which is held to produce income and with respect to which there is acquisition indebtedness" (sec. 514(b)(1)). A debt constitutes acquisition indebtedness with respect to property if the debt was incurred in acquiring or improving the property, or if the debt would not have been incurred "but for" the acquisition or improvement of the property.[2]

The provisions relating to unrelated debt-financed income generally applied to taxable years beginning after December 31, 1969.[3] The 1969 Act provided a transitional rule under which the Clay Brown rules were to apply only where indebtedness had been incurred after the date on which similar bills were introduced in the 89th Congress (June 27, 1966) until taxable years beginning after 1971. After the transition period, the new rules were applicable to all situations of investment borrowing by exempt organizations.

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[1] There are some exceptions to the general rule that passive investment income is tax-exempt. For example, social clubs (sec. 501(c)(7)) and voluntary employees beneficiary associations (sec. 501(c)(9)) are generally taxed on such income. Also, private foundations are subject to an excise tax of 2 percent on their net investment income.

[2] There are several exceptions from the term "acquisition indebtedness." For instance, one exception is indebtedness on property which an exempt organization receives by devise, bequest, or under certain conditions, by gift. Also, the term "acquisition indebtedness" does not include indebtedness which was necessarily incurred in the performance or exercise of the purpose or function constituting the basis of the organization's exemption. Special exceptions are also provided for the sale of annuities and for debts insured by the Federal Housing Administration to finance low- and moderate-income housing.

[3] However, in extending the unrelated debt-financed income rule and other rules relating to the unrelated business income tax to churches, the 1969 Act provided that these provisions did not apply to churches for taxable years beginning before January 1, 1976.

Issue

The issue is whether a limited exception to the debt-financed income rules should be provided for income derived from certain sales of real property during 1976 in situations where the indebtedness was incurred prior to 1965.

Explanation of provision

The bill would provide a very limited exception to the debt-financed income rules. Under this exception, it is provided that, in applying the debt-financed income rules to any sale of real property during 1976, indebtedness incurred before January 1, 1965, by an organization to finance the construction of a building on such property shall not be treated as acquisition indebtedness if the parcel of real property on which the building was constructed (1) was acquired by the organization before January 1, 1952, and (2) is contiguous to another parcel of real property which (*a*) was acquired by the organization before January 1, 1952, and (*b*) was used by the organization for exempt purposes (for the entire period from January 1, 1952, until the date of enactment of the bill).

Although this provision may possibly benefit other taxpayers, it is primarily intended to provide tax-free treatment for a 1976 sale of real property by the Tillamook County Young Men's Christian Association (YMCA), Tillamook, Oregon. The real property sold by the Tillamook YMCA was property adjacent to property it used for carrying on its charitable and educational purposes.

Effective date

This provision would apply only to certain sales of real property during calendar year 1976.

Revenue effect

It is estimated that this provision would result in a one-time reduction in budget receipts of less than $50,000 in fiscal year 1980.

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