

[JOINT COMMITTEE PRINT]

DESCRIPTION OF MISCELLANEOUS
TAX BILLS

LISTED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON TAXATION AND
DEBT MANAGEMENT GENERALLY

OF THE

COMMITTEE ON FINANCE

ON MAY 30, 1980

PREPARED FOR THE USE OF THE

COMMITTEE ON FINANCE

BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION



MAY 28, 1980

U.S. GOVERNMENT PRINTING OFFICE

62-581 O

WASHINGTON : 1980

JCS-26-80

CONTENTS

	Page
Introduction.....	1
I. Summary.....	3
II. Description of Bills.....	5
1. S. 2484 (Senators Riegle and Levin): Recapture of foreign losses.....	5
2. S. 2486 (Senators Culver, McGovern and Baucus): Tax exemption for industrial development bonds for railroad rehabilitation.....	7
3. S. 2500 (Senators Moynihan, Javits and Heinz): Theatrical Production Investment Tax Credit Act of 1980.....	9
4. S. 2503 (Senator Kassebaum): Refundable tax credit for certain interest on agricultural loans.....	11
5. S. 2526 (Senator Baucus): Tax exemption for industrial development bonds for facilities used to furnish railroad transportation.....	14
6. S. 2548 (Senator Stone): Tax exemption for in- dustrial development bonds to refinance certain certain docks and wharves.....	15

INTRODUCTION

The bills described in this pamphlet have been scheduled for a hearing on May 30, 1980, by the Senate Finance Subcommittee on Taxation and Debt Management Generally. There are 6 Senate bills described in the pamphlet (S. 2484, S. 2486, S. 2500, S. 2503, S. 2526 and S. 2548).

The first part of the pamphlet is a summary of the bills presented in bill numerical order. 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.

(A separate pamphlet describes the House-passed Bankruptcy Tax Act of 1980, H.R. 5043, which is also scheduled for the May 30 Subcommittee hearing.)

I. SUMMARY

1. S. 2484—Senators Riegle and Levin

Recapture of Foreign Losses

The bill would expand the application of an exception to the general effective date of the foreign loss recapture provisions of the Tax Reform Act of 1976. Under the 1976 Act, the foreign loss recapture provisions generally apply to losses sustained after 1975. Certain exceptions to the effective date were made for losses attributable to investments in foreign subsidiaries which were substantially worth less on the effective date. Under one of these exceptions, where a loss was sustained in 1976 with respect to such a substantially worthless subsidiary, the full amount of the loss was exempt from recapture. Under a second, more limited exception, losses on such substantially worthless subsidiaries sustained after 1976 but before 1979 were exempt from recapture to the extent of the deficit in the earnings and profits of the subsidiary as of the general December 31, 1975, effective date. The bill would expand these exceptions so that the full amount of such losses sustained in the period after 1976 but before 1979 would be exempt from recapture if substantially all the employees of the foreign subsidiary were discharged before April 15, 1977.

2. S. 2486—Senators Culver, McGovern, and Baucus

Tax Exemption for Industrial Development Bonds for Railroad Rehabilitation

Under present law, tax-exempt industrial development bonds may be used to provide certain transportation facilities (e.g., airports, docks, wharves, mass commuting facilities, and public parking facilities). The bill would allow the use of tax-exempt industrial development bonds for the financing of railroad rehabilitation and the acquisition of land and rights-of-way in conjunction with railroad rehabilitation.

3. S. 2500—Senators Moynihan, Javits, and Heinz

Theatrical Production Investment Tax Credit Act of 1980

Under present law, taxpayers are entitled to receive an investment credit for certain tangible personal property that is placed in service by the taxpayer. The presentation of a dramatic work, such as a play or opera, before a live audience is not tangible personal property, and no investment credit is allowed for an investment in a theatrical production. The bill would allow an investment credit for qualified investments in certain theatrical productions.

4. S. 2503—Senator Kassebaum**Refundable Tax Credit for Certain Interest on Agricultural Loans**

The bill would allow a tax credit equal to the amount of interest paid on certain agricultural operating loans on a principal amount not exceeding \$25,000 to the extent that the interest is attributable to a rate that exceeds 12 percent and does not exceed the 90-day commercial paper rate by more than 5 percentage points.

5. S. 2526—Senator Baucus**Tax Exemption for Industrial Development Bonds for Facilities Used To Furnish Railroad Transportation**

Under present law, tax-exempt industrial development bonds may be used to provide certain transportation facilities (e.g., airports, docks, wharves, mass commuting facilities, and public parking facilities). The bill would allow tax-exempt industrial development bonds to be used to provide facilities, including rolling stock, for railroad transportation.

6. S. 2548—Senator Stone**Tax Exemption for Industrial Development Bonds Used To Refinance Certain Docks and Wharves**

Under present law, tax-exempt industrial development bonds may be used to provide docks and wharves. However, such obligations will not be tax-exempt where they are used to refinance existing docks and wharves which were not originally financed with tax-exempt bonds. The bill would allow the use of tax-exempt industrial development bonds for the refinancing of existing docks and wharves in Tampa, Florida, which were not originally financed with tax-exempt bonds.

II. DESCRIPTION OF BILLS

1. S. 2484—Senators Riegle and Levin

Recapture of Foreign Losses

Present law

Where a taxpayer's foreign operations result in a net overall foreign loss for a particular taxable year, that net foreign loss will reduce the taxpayer's U.S. tax on its U.S. source income for that year by decreasing the worldwide taxable income on which the U.S. tax was based. In addition, prior to the Tax Reform Act of 1976, if the taxpayer earned net income from foreign sources in future years, no reduction in the taxpayer's foreign tax credit limitation was made to recapture the prior benefits from foreign losses (except in the case of foreign oil related losses, which were subject to recapture pursuant to amendments made by the Tax Reduction Act of 1975). Thus, in such situations, the taxpayer reduced its U.S. tax on its U.S. income as the result of the foreign loss while not paying U.S. tax on its foreign operations when they generated net income because of the foreign tax credit.

To reduce these advantages, the 1976 Act extended the recapture provisions to all foreign losses. The recapture rules are intended to ensure that the foreign tax credit cannot be used against U.S. source income. The Act requires that, in cases where a loss from foreign operations reduces U.S. tax on U.S. source income, the loss is to be recaptured by the United States if the company subsequently derives income from abroad. In general, the recapture is accomplished by treating a portion of foreign income which is subsequently derived as income from domestic sources.

The loss recapture provisions generally apply to losses sustained in taxable years beginning after December 31, 1975. An exception to the general effective date was provided for cases where a loss sustained in 1976 is from a direct investment in a foreign subsidiary which was substantially worthless prior to the effective date and the taxpayer terminated all operations of the corporation before January 1, 1977, through a sale, liquidation or other disposition of the corporation or its assets. This exception applied where a corporation suffered an operating loss in three out of the five years preceding the year in which the loss was sustained, and the corporation sustained an overall loss for those five years.

A second, limited exception was provided for taxpayers who satisfied the other requirements of the first exception but failed to qualify because the operations of the foreign subsidiary were not terminated in 1976. If the operations were continued after 1976 but were terminated before 1979, the loss would nevertheless not be subject to recapture, to the extent of the deficit in the subsidiary's earnings and profits on the general effective date of the recapture provisions (December 31, 1975).

Issue

The issue is whether the second exception to the December 31, 1975, effective date of the foreign loss recapture provisions (applicable to investments terminated after 1976 but before 1979 as described above) should be expanded to exempt from recapture the full amount of the loss, rather than just the loss realized by the subsidiary before 1976, where substantially all of the foreign corporation's employees were discharged before April 15, 1977.

Explanation of the bill

Under the bill, a loss on the termination of an investment in a foreign subsidiary after 1976 but before 1979 which qualifies for the limited second exception to the December 31, 1975, effective date (but not the first) would be exempt in full recapture (rather than just to the extent of the deficit in earnings and profits as of the general effective date) if substantially all of the employees of the terminated corporation are discharged before April 15, 1977.

The principal beneficiary of the bill would be the Sealed Power Corporation.

Effective date

The bill would be effective as of October 4, 1976, the date of enactment of the 1976 Act.

Revenue effect

According to preliminary estimates, this provision will reduce budget receipts by less than \$10 million annually for the next several years.

2. S. 2486—Senators Culver, McGovern, and Baucus

Tax Exemption for Industrial Development Bonds for Railroad Rehabilitation

Present law

Under present law, interest on State and local government obligations is generally exempt from Federal income tax. However, since 1968, tax exemption has been denied to State and local government issues of industrial development bonds (IDBs). A State or local government bond is an IDB if (1) all or a major portion of the proceeds of the issue are to be used in any trade or business of a person other than a State or local government or tax-exempt organization, and (2) payment of principal or interest is secured by an interest in, or derived from payments with respect to, property or borrowed money used in a trade or business.

An exception to the denial of tax exemption for IDBs applies in the case of such obligations which are used to provide exempt activity facilities, including certain types of transportation facilities, e.g., airports, docks, wharves, mass commuting facilities, and public parking facilities (Code sec. 103(b)(4)(D)). No exception is provided under present law for IDBs used to provide financing for railroad rehabilitation.

The exception for IDBs for exempt activity facilities applies where the proceeds of an IDB are to be used to finance the construction of a new facility or to finance the acquisition of an existing facility from an unrelated person. However, under the IRS regulations, the exception does not apply where the proceeds of an IDB are to be used to refinance an existing facility which was not originally financed with tax-exempt bonds (e.g., it was conventionally financed). Under these IRS regulations, the exception will apply to the financing of an existing facility only where the person who was a substantial user of the facilities before issuance of the obligations and who receives the proceeds of the obligation will not be a substantial user of the facilities following the issuance of the obligations (Treas. Reg. sec. 1.103-8(a)(5)(iv)). In general, a substantial user of a facility includes any non-exempt person who regularly uses a part of such facility in his trade or business where (1) the gross revenue derived by such user with respect to such facility is more than 5 percent of the total revenue derived by all users of such facility or (2) the amount of area of the facility occupied by such user is more than 5 percent of the entire usable area of the facility (Treas. Reg. sec. 1.103-11(b)). For example, an IDB would not be tax exempt in the case where the proceeds of the obligation are used by a governmental entity to purchase an exempt activity facility which is then, in turn, leased back to the prior owner for a period equal to the useful life of the facility.

Issue

The principal issue is whether tax-exempt IDBs should be allowed to be used to provide financing for railroad rehabilitation. A subsidiary issue is whether tax-exempt IDBs should be allowed to be used to refinance existing conventionally financed railroad systems.

Explanation of the bill

The bill provides that interest on an industrial development bond would be exempt from Federal income taxation where substantially all the proceeds of the bond are used to provide financing for railroad rehabilitation or the acquisition of land or rights-of-way in connection with railroad rehabilitation. Under the bill, railroad rehabilitation includes the acquisition, construction, reconstruction, or erection of any roadbed, track, trestle, depot, switching and signal equipment, or any related equipment, but not rolling stock.

Finally, under the bill, it is unclear whether tax-exempt IDBs may be used for the refinancing of existing conventionally financed railroad systems.

Effective date

The bill would apply to obligations issued after September 30, 1980.

Revenue effect

It is estimated that this bill would reduce budget receipts by \$1 million in fiscal year 1980, \$30 million in 1981, \$80 million in 1982, \$180 million in 1983, \$300 million in 1984 and \$460 million in 1985. (For these estimates, it is assumed that tax-exempt refinancing of existing facilities would not be allowed.)

3. S. 2500—Senators Moynihan, Javits, and Heinz

Theatrical Production Investment Tax Credit Act of 1980

Present law

Under present law, taxpayers are entitled to receive an investment tax credit for qualified tangible personal property which is placed in service by the taxpayer (Code sec. 38). In order to receive the full credit, the property placed in service by the taxpayer must have a useful life of at least 7 years. If the property has a useful life of at least 5 years (but less than 7 years) the taxpayer is entitled to two-thirds of the full credit. If the property has a useful life of at least 3 years (but less than 5 years) the taxpayer is entitled to one-third of the full credit. In addition, the property will cease to qualify as section 38 property if, during any taxable year, there is any predominant foreign use of the property.

The Tax Reform Act of 1976 provided rules that clarified and modified the application of the investment tax credit to movies and television films. Under these rules, all of the direct production costs and certain indirect costs of movies or films qualify for the investment tax credit. The taxpayer may use the actual useful life of the movie or film to determine the amount of the investment credit or, at his election, the taxpayer may receive an investment tax credit for two thirds (66⅔ percent) of the full investment tax credit regardless of the useful life of the movie or film. The Act also contains detailed rules to insure that the investment tax credit applies to production costs generally incurred in the United States regardless of where the movie or film is shown. In addition, a taxpayer is entitled to the investment tax credit only if he has an ownership interest in the movie or film.

No investment tax credit is allowed for the costs of producing a dramatic work before a live audience, such as a play or opera, because a play, opera, or other live presentation is not considered tangible personal property.

Issue

The issue is whether taxpayers should be allowed an investment tax credit for qualified investments in certain theatrical productions.

Explanation of the bill

The bill would allow an investment credit for qualified investments in "theatrical productions". The credit allowed under Code section 38 would be based on two-thirds (66⅔ percent) of the qualified United States production costs. The bill contains detailed rules, similar to those contained in the Tax Reform Act of 1976 for movies and television films, to exclude foreign production costs from being eligible for the investment tax credit. A credit would be allowed only to the extent the taxpayer has an ownership interest in the theatrical production.

The bill defines "theatrical production" as the presentation of a dramatic work in a commercial theater before a live audience. The definition includes plays, musicals, operas, and ballets. A presentation primarily for use in a film or nightclub or on radio or television, however, would not qualify for an investment tax credit under the bill.

Effective date

The effective date of the provisions is not specified in the bill.

Revenue effect

This bill is estimated to reduce budget receipts by less than \$5 million annually.

4. S. 2503—Senator Kassebaum

Refundable Tax Credit for Certain Interest on Agricultural Loans

Present law

Tax credit

Under present law, no income tax credit is allowed a taxpayer for interest paid or incurred with respect to any debt.

Deduction for interest expense

In general, interest expense is allowed as a deduction in the taxable year paid or incurred, depending upon the taxpayer's method of accounting (Code sec. 163). If a taxpayer uses the cash receipts and disbursements method of accounting to compute taxable income, interest which is properly allocable to any later taxable year must be charged to the capital account and treated as paid in the periods in which (and to the extent that) the interest represents a charge for the use or forbearance of borrowed money during each such taxable year (Code sec. 461(g)).

In the case of a taxpayer other than a corporation which is not a subchapter S corporation or a personal holding company, real property construction period interest is to be capitalized in the year in which paid or accrued and amortized over a 10-year period after a transitional period. A portion of the amount capitalized may be deducted for the taxable year in which paid or accrued. The balance must be amortized over the remaining years in the amortization period beginning with the year in which the property is ready to be placed in service or is ready to be held for sale (Code sec. 189).

With respect to interest on investment indebtedness, present law limits the deduction to \$10,000 per year increased by the amount of the taxpayer's net investment income (Code sec. 163(d)). However, except for construction period interest, there is no limitation on the amount of interest allowed as a deduction that is incurred in connection with a trade or business.

Issue

The principal issue is whether a refundable tax credit for certain interest paid or incurred on agricultural loans should be provided. Subsidiary issues include whether the credit should be available with respect to loans between related persons and, if not, what definition of related persons should be prescribed.

Explanation of the bill

The bill would provide a refundable¹ tax credit for certain interest

¹ Appropriations acts may be required for the Internal Revenue Service to make payments of the portion of the credit which exceeds the taxpayer's tax liability. See section 303 of Public Law 95-355 (92 Stat. 563-4).

paid or incurred by the taxpayer on agricultural operating loans. In general, the amount of the credit is equal to the excess of the interest paid or incurred on agricultural operating loans over the interest which would have been paid had the annual percentage rate of interest on the loan been 12 percent. The interest to be taken into account for purposes of computing the credit may not exceed the discount rate, including any surcharge, on 90-day commercial paper in effect at the Federal Reserve bank in the Federal Reserve district where the taxpayer resides, increased by 5 percentage points. Additionally, only interest paid or incurred on \$25,000 of original principal amount may be taken into account. To the extent a taxpayer claims a credit for the interest on agricultural operating loans, no deduction for such amount would be allowed. Also, no credit would be allowed for interest paid to a related person (as determined pursuant to the regulations under Code sec. 52(b)). In the case of subchapter S corporations, estates and trusts (and presumably partnerships), under regulations prescribed by the Secretary of the Treasury, the credit is to pass through to the shareholders and beneficiaries, respectively (and the partners).

Under the bill, the term "agricultural operating loan" means a loan with a maturity not to exceed 12 months, the proceeds of which are to be used for a purpose described in section 312 of the Consolidated Farm and Rural Development Act (7 U.S.C. 1942). This section generally provides that:

"(a) Loans may be made under this subchapter for (1) paying costs incident to reorganizing the farming system for more profitable operation, (2) purchasing livestock, poultry, and farm equipment, (3) purchasing feed, seed, fertilizer, insecticides, and farm supplies and to meet other essential farm operating expenses including cash rent, (4) financing land and water development, use, and conservation, (5) without regard to the requirements of section 1941(a)(2) and (3) of this title, to individual farmers or ranchers to finance outdoor recreational enterprises or to convert to recreational uses their farming or ranching operations, including those heretofore financed under this chapter, (6) enterprises needed to supplement farm income, (7) refinancing existing indebtedness, (8) other farm and home needs including but not limited to family subsistence, (9) loan closing costs, and (10) for assisting farmers or ranchers in effecting additions to or alterations in the equipment, facilities, or methods of operation of their farms or ranches in order to comply with the applicable standards promulgated pursuant to section 655 of Title 29 or standards adopted by a State pursuant to a plan approved under section 667 of Title 29, if the Secretary determines that any such farmer or rancher is likely to suffer substantial economic injury due to such compliance without assistance under this paragraph.

"(b) Loans may also be made under this subchapter to residents of rural areas without regard to the requirements of clauses (2) and (3) of section 1941(a) of this title to operate in rural areas small business enterprises to provide such residents with essential income."

"(c) Loans may also be made to eligible applicants under this subchapter for pollution abatement and control projects in rural areas.

Effective date

The provisions of the bill would be effective with respect to taxable years beginning after December 31, 1979.

Revenue effect

It is estimated that the bill would decrease Federal budget receipts by \$16 million in fiscal year 1980, \$182 million in 1981, \$85 million in 1982, and \$49 million in 1983.

5. S. 2526—Senator Baucus

Tax Exemption for Industrial Development Bonds for Facilities Used To Furnish Railroad Transportation

Present law

Under present law, interest on State and local government obligations is generally exempt from Federal income tax. However, since 1968, tax exemption has been denied to State and local government issues of industrial development bonds (IDBs). A State or local government bond is an IDB if (1) all or a major portion of the proceeds of the issue are to be used in any trade or business of a person other than a State or local government or tax-exempt organization, and (2) payment of principal or interest is secured by an interest in, or derived from payments with respect to, property or borrowed money used in a trade or business.

An exception to the denial of tax exemption for IDBs applies in the case of such obligations which are used to provide "exempt activity" facilities, including certain types of transportation facilities (e.g., airports, docks, wharves, mass commuting facilities and public parking facilities) (Code sec. 103(b)(4)(D)). No exception is provided under present law for IDBs used to provide facilities, including rolling stock, for the furnishing of railroad transportation.

Issue

The issue is whether tax-exempt IDBs should be allowed to be used to provide facilities, including rolling stock, for the furnishing of railroad transportation.

Explanation of the bill

The bill provides that interest on an industrial development bond would be exempt from Federal income taxation where substantially all the proceeds of the bond are to be used to provide facilities, including rolling stock, for the furnishing of railroad transportation. It is unclear whether the bill would apply only to rolling stock and other facilities which are owned by or leased to regulated railroad systems or whether it would also apply to rolling stock and other facilities owned by or leased to industries (e.g., a tank car owned by or leased to a chemical company).

Effective date

The bill would apply to obligations issued on or after the date of enactment.

Revenue effect

If the bill does not apply to companies that lease equipment to railroads, budget receipts would be reduced by \$2 million in fiscal year 1980, \$40 million in 1981, \$130 million in 1982, \$280 million in 1983, \$480 million in 1984, and \$720 million in 1985. However, if equipment leasing companies are eligible for tax-exempt financing under the provision of the bill, preliminary estimates indicate that budget receipts would be reduced by approximately \$0.1 billion in fiscal year 1981, \$0.2 billion in 1982, \$0.5 billion in 1983, \$0.8 billion in 1984, and \$1.3 billion in 1985.

6. S. 2548—Senator Stone

Tax Exemption for Industrial Development Bonds Used to Refinance Certain Docks and Wharves

Present law

Under present law, interest on State and local government obligations is generally exempt from Federal income tax. However, since 1968, tax exemption has been denied to State and local government issues of industrial development bonds (IDBs). A State or local government bond is an IDB if (1) all or a major portion of the proceeds of the issue are to be used in any trade or business of a person other than a State or local government or tax-exempt organization, and (2) payment of principal or interest is secured by an interest in, or derived from payments with respect to, property or borrowed money used in a trade or business.

An exception to the denial of tax exemption for IDBs applies in the case of such obligations which are used to provide exempt activity facilities, including docks and wharves (Code sec. 103(b)(4)(D)). This exception applies where the proceeds of an IDB are to be used to finance the construction of a new facility or to finance the acquisition of an existing facility from an unrelated person. However, under the IRS regulations, the exception does not apply where the proceeds of an IDB are to be used to refinance an existing facility which was not originally financed with tax-exempt bonds (e.g., it was conventionally financed). Under these IRS regulations, the exception will apply to the financing of an existing facility only where the person who was a substantial user of the facilities before issuance of the obligations and who receives the proceeds of the obligation will not be a substantial user of the facilities following the issuance of the obligations (Treas. Reg. sec. 1.103-8(a)(5)(iv)). In general, a substantial user of a facility includes any nonexempt person who regularly uses a part of such facility in his trade or business where (1) the gross revenue derived by such user with respect to such facility is more than 5 percent of the total revenue derived by all users of such facility or (2) the amount of area of the facility occupied by such user is more than 5 percent of the entire usable area of the facility (Treas. Reg. sec. 1.103-11(b)). For example, an IDB would not be tax exempt in the case where the proceeds of the obligation are used by a governmental entity to purchase docks and wharves which are then, in turn, leased back to the prior owner for a period equal to the useful life of the docks and wharves.

Issue

The issue is whether tax-exempt IDBs should be allowed to be used to refinance certain existing conventionally financed docks and wharves located in Tampa, Florida.

Explanation of the bill

The bill provides that interest on certain IDBs used to refinance existing conventionally financed docks and wharves in Tampa, Florida, would be exempt from Federal income taxation. In order to qualify under this provision, six requirements must be satisfied. First, part of the proceeds of the obligations must be used to make substantial improvements in the existing wharf facilities acquired with the obligations. Second, it must reasonably be expected that there will be more than one person who is a substantial user of the facilities after the issuance of the obligations. Third, at least one of the substantial users of the existing wharf facility after the issuance of the obligations must not have been a substantial user before the issuance of the obligation. Fourth, all facilities with respect to which financing is provided must be owned by the issuing governmental unit. Fifth, the only interest in such facilities to be held by a substantial user must be a lease executed after issuance of the obligations for a period (including options) of not more than 80 years and under which no lessee has an option to purchase the facilities. Finally, the facilities must be located in a port with respect to which section 101 of Public Law 91-611 authorized the initiation and partial accomplishment of a project as described in House Document No. 91-401.¹

The principal beneficiary of this bill would be the Agrico Chemical Company.

Effective date

The bill would be effective for obligations issued after the date of enactment.

Revenue effect

It is estimated that this bill would reduce budget receipts by \$1 million in fiscal year 1981, \$2 million in 1982, and \$3 million in 1983, 1984 and 1985.

¹ This document describes only the Port of Tampa, Fla.

