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TAX TREATMENT OF BANK HOLDING COMPANY DIVESTITURES

PREPARED FOR THE USE OF THE

COMMITTEE ON WAYS AND MEANS

BY THE STAFF OF THE

JOINT COMMITTEE ON INTERNAL REVENUE TAXATION

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General

The basic thrust of the Bank Holding Company Act is to provide for the regulation of bank holding companies by the Federal Reserve Board. A principal objective of the legislation is to require bank holding companies to separate their business of managing and controlling banks from unrelated businesses. Under the Act, a "bank holding company" means any company which has control over any bank or over any company that is or becomes a bank holding company.

In general, the Bank Holding Company Act Amendments of 1970 require a bank holding company (defined generally as any company controlled two or more banks were permitted to make tax-free distributions (referred to as "spinoffs") of either their bank or nonbank anticipated that the Congress would later consider the need for legislation to provide relief from any tax burden resulting from the divestitures required under the Amendments.[1]

With respect to distributions previously required under the Bank Holding Company Act of 1956 (and its amendment in 1966), corporations which were classified as bank holding companies because they controlled two or more banks were permitted to make tax-free distributions (referred to as "spinoffs") of either this bank or nonbank assets, as the case may be. This special treatment provides for the nonrecognition of any gain to the shareholders upon the distribution to them of stock of a banking or nonbanking subsidiary. The tax on any gain would be imposed on the shareholders upon their later disposition of the stock received in the spinoff.

No similar tax relief has been extended, as yet, to distributions required by one-bank holding companies under the 1970 amendments.

In the case of other government mandated divestitures, nonrecognition of gain or loss treatment has been provided with respect to certain exchanges required under Federal Communications Commission policies (sec. 1071) and certain exchanges or distributions made in obedience to orders of the Securities and Exchange Commission (sec. 1081). In addition, special provisions have been enacted to treat certain distributions of stock pursuant to an order enforcing the antitrust laws as a return of capital to the shareholders rather than dividend distributions (sec. 1111).

History of Bank Holding Company Legislation

The first legislation directed specifically toward Federal regulation of bank holding companies arose in 1956. During the preceding

[1] A statement to this effect was included in the 1970 committee report of the Senate Banking and Currency Committee, as indicated below.

two decades there had arisen a growing concern about concentrations of economic power if holding companies were allowed to control not only large numbers of banks but also nonbanking enterprises. The Bank Holding Company Act of 1956 was enacted in response to this concern. A bank holding company was defined in the 1956 Act as an entity which owned or controlled 25 percent or more of the voting shares of two or more banks. Under the Act, it was unlawful for a company to become a bank holding company without prior approval of the Federal Reserve Board, and permission was also required for further concentration of banking entities under single control. Finally, bank holding companies were generally required to divest themselves of nonbanking affiliates within a maximum period of five years and to refrain from future acquisitions of such enterprises. Some exceptions were provided to the definition of a bank holding company and there were also some situations where control of nonbanking activity was to be permitted under the 1956 Act. Application of the 1956 Act to one-bank holding companies was considered and rejected in 1956 based on the conclusion that at that time there existed only a remote possibility a harmful concentration of economic power would arise where only one bank was involved.

In general, a corporation coming within the terms of the bank holding company legislation was given its choice of two alternative routes—to remain a bank holding company, or to dispose of its interest in banks. If the corporation decided to remain a bank holding company subject to the supervision of the Federal Reserve Board, it had to divest itself of any so-called "prohibited property," or nonbank assets.

In 1966, a number of technical amendments were made to the 1956 Act and one exception to the definition of bank holding company was removed.[2] Consideration again was given to extending the Act to apply to one-bank holding companies. However, the enacted amendments did not extend Federal regulation to one-bank holding companies.

During the late 1960's, there was a dramatic growth not in only the number of commercial banking enterprises which became affiliated with one-bank holding companies, but also in the extent such entities controlled commercial banking activity. For example, the Federal Reserve Board has indicated that 550 one-bank holding companies were known to exist in 1965 and that these companies were typically small concerns controlling small banks. However, by the end of 1970, the total number of one-bank holding companies had grown to over 1,300 and these companies controlled over one-third (38 percent) of all U.S. commercial bank deposits. Over 1,100 of the 1,300 companies were engaged in nonbank activities either directly or through nonbank subsidiaries with the nonbank subsidiaries alone having total assets in excess of $46 billion. Approximately one-half of the companies became operational after June 1, 1968.[3]

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[2] The repealed exception had provided that a company was not to be considered a bank holding company if it was registered prior to May 15, 1955, under the Investment Company Act of 1940 (or was an affiliate of such a company) unless the company or its affiliate *directly* owned 25 percent or more of the voting shares of each of two or more banks.

[3] With respect to these 1,300 companies, 715 companies were engaged in activities which were not closely related to banking (371 were formed before June 1968 and 344 were formed thereafter). According to data compiled by the Federal Reserve Board as of December 31, 1970, the majority of all one-bank holding companies (parent company only) are small: 74 percent reported total assets of less than $5 million, and 88 percent had less than $25 million. A few companies reported assets of $1 billion or more. (Federal Reserve Bulletin, December, 1972, pp. 999–1008.)

This rapid change in the structure of U.S. commercial banking ownership caused renewal of congressional concern over anti-competitive affiliations of banking and nonbanking activities. As a result, the Congress enacted the Bank Holding Company Amendments of 1970.

Of the 1970 amendments, the most significant is the extension of the Act to cover, for the first time, one-bank holding companies (i.e., any company controlling 25 percent or more of the voting shares of a bank). As a result, one-bank holding companies are made subject to the requirements of the Federal Reserve Board regarding expansion in their banking activities. In addition, one-bank holding companies which are engaged in both banking and nonbanking activities are generally required to divest themselves of either the banking or nonbanking assets before January 1, 1981. However, a "grandfather clause" was enacted in the 1970 amendments, under which a one-bank holding company is generally not required to divest itself of those nonbanking activities in which it was lawfully engaged on June 30, 1968.[4]

In addition, the Federal Reserve Board is authorized to determine that a company owning between 5 percent and 25 percent of the voting stock of a bank or nonbanking corporation possessed a "controlling influence" in the bank or nonbank and should also be treated as controlling the bank or nonbanking corporation.

The report of the Senate Committee on Banking and Currency contained the following discussion concerning the tax treatment of the divestitures to be required:[5]

> It is anticipated that the Congress will follow precedent and will pass a bill providing companies required to make divestitures under this legislation with relief from an undue tax burden as a result of such divestiture. It would be inequitable to require these divesting companies to commit themselves to a divestiture plan without knowing precisely what their tax situation will be in regard to such divestiture. Accordingly, it was deemed necessary to provide a divestiture period of sufficient length that these companies will have adequate time to make their divestiture plans after the appropriate tax relief measure is passed by Congress.

Tax Treatment of Divestitures Under the 1956 and 1966 Legislation

At the time of enactment of the 1956 legislation, Congress also enacted tax provisions designed to facilitate the disposition of either the bank or nonbanking assets. Under these provisions corporations classified as bank holding companies in 1956 were permitted to make tax-free distributions of either their bank or nonbank stock or assets, as the case may be. This is referred to as a tax-free "spinoff," in which stock or property of the company being divested is distributed to the shareholders of the bank holding company with, or without, an ex-

[4] Properties which are subect to the grandfather provision are not subect to the divestiture requirements; however, in a situation of this type the Board retains significant controls on the authority of the bank holding company to acquire new businesses or to expand existing businesses, and may terminate applicability of the grandfather clause for a company in certain cases.

[5] S. Rep. No. 91–1084, 91st Cong., 2nd Sess. 7 (1970).

change of their stock in the bank holding company. The tax on any gain realized by a shareholder is generally postponed until the shareholder disposes of the stock or property.

If gain was not recognized with respect to a distribution of property in exchange for stock or securities, the basis of the property received was the same as the basis of the stock or securities exchanged. If property was distributed without the exchange of stock, the shareholder was required to allocate his basis in the stock between the stock and the property distributed to him.

In the absence of the special tax provisions, most property distributions would have been treated as dividends taxable as ordinary income to the shareholders receiving them. Dividend treatment would not be imposed, however, if the distribution could qualify as a tax-free division under present law (sec. 355). If the holding company's shareholders do exchange some of their shares in the holding compnay for a divestiture distribution by the holding company, the exchange would have been treated, absent these special tax provisions, as a taxable exchange on which the shareholders recognize gain or loss (unless the exchange could qualify for nonrecognition of gain or loss under the special spinoff rules of sec. 355 of present law).

Congress extended the same tax treatment to a divestiture made pursuant to the 1966 Bank Holding Company Amendments as was provided under the 1956 provisions. However, with respect to the 1966 tax provisions all distributions were required to be pro rata among each class of shareholders of the bank holding company in order to qualify for tax-free treatment. (Under the 1956 tax provisions, the distributions were not required to be pro rata; thus, distributions could have been made to some but not all shareholders.)

The Federal Reserve Board had to certify under both the 1956 and 1966 Acts that the distribution of stock or assets was necessary or appropriate to effectuate the policies of the bank holding company legislation.[6]

Cutoff dates were provided in both cases for the availability of the special tax treatment. The Bank Holding Company Act of 1956 restricted the nonrecognition of gain treatment to property which was owned by a company on May 15, 1955. In the case of the 1966 amendments, the tax-free treatment was available only with respect to property owned on April 12, 1965 (the date of introduction of the bill which led to the enactment of the 1966 amendments). These restrictions were considered necessary to prevent corporations from purchasing interests in banks or other businesses in order that their shareholders might benefit from the tax-free distribution treatment provided.[7]

Issue

In the absence of special tax legislation, many distributions required to be made pursuant to the Bank Holding Company Act

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[6] The Federal Reserve Board was required to make both an initial certification before any distribution by a bank holding company as well as a final certification that the required distribution had been made.

[7] In the case of both amendments, a "substituted property" rule was provided so that certain property acquired after the respective cutoff dates was eligible for nonrecognition treatment. Property eligible for this treatment included property acquired by a distributing corporation in a transaction in which gain was not recognized by reason of a liquidation of a subsidiary or a type "(E)" or "(F)" reorganization (a recapitalization or mere change in identity, form, or place of organization) involving a subsidiary of the distributing corporation.

Amendments of 1970 will be taxable to the distributees as dividends subject to ordinary income rates.[8]

In addition, the bank holding company itself generally would be required to recognize gain on appreciated property (such as stock of a banking or nonbanking subsidiary) distributed by it in a redemption of its own stock, unless the distribution is treated as a distribution in complete or partial liquidation of the company.[9]

On the other hand, if property is sold to satisfy the divestiture requirements, nonrecognition of gain under the involuntary conversion provision of the tax law (sec. 1033) is not available since this provision does not treat these divestitures as an involuntary conversion and even if it did, the provision would not apply because reinvestment in "similar" poverty is prohibited; e.g., in bank stock where a company ceases to be a bank holding company.

An initial decision to be made by the committee is whether to extend any special tax relief to bank holding companies with respect to divestitures. If the committee should decide to provide special tax relief, it may wish to re-examine the type of relief provided in 1956 and 1966. While the tax-free spinoff relief provided in 1956 and 1966 may be appropriate for some of the divestitures made pursuant to the 1970 amendments, it has been urged that the number and types of bank holding companies which are subject to the 1970 legislation will, in many instances, make inappropriate the tax relief which was given in 1956 and 1966. Some of the bank holding companies which will be subject to the 1970 amendments are widely held. In such a situation, the distribution of the stock of a subsidiary to the shareholders of the bank holding company would frequently result in many of the holding company's shareholders receiving only a small number of shares (or in same cases fractions of whole shares). Further, if the distribution consists of stock issued by a bank which serves only a local or regional market, the shareholders of the holding company would receive an investment in which they have little or no interest.[10]

In those cases where it is not feasible to distribute stock, many bank holding companies would be forced to sell the interests required to be divested. In these circumstances, it has been suggested that alterna-

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[8] Generally, in the case of a redemption of stock by a bank holding company, the redemption would be treated as a sale or exchange of a capital asset by the shareholder rather than a dividend only if the redemption is not essentially equivalent to a dividend (sec. 302) or if the redemption is treated as a distribution in complete or partial liquidation of the company (sec. 331). Nonrecognition treatment would be available of the distribution qualified under the divisive reorganization provisions of present law (sec. 355). This provision permits a corporation to distribute to its own shareholders stock of a controlled (80 percent or greater ownership) corporation without an immediate dividend tax or recognition of gain by the receiving shareholders. Under this provision, the shareholders may or may not simultaneously exchange some of their stock in the distributing company. Several prerequisites must be satisfied before this benefit under section 355 can be obtained, however. Two of these requirements are that both corporations must be engaged in active conduct of a trade or business immediately after the distribution, and the distributed company must have actively conducted a trade or business for at least 5 years before the distribution.

[9] Under the Tax Reform Act of 1969, recognition of gain by a corporation using appreciated property to redeem its own stock was required in certain cases (sec. 311(d)). Included among the exceptions to this rule was a distribution of stock or securities pursuant to a final judgment under an antitrust proceeding. A similar exception for distributions required under the Bank Holding Company Act was not considered necessary at that time.

[10] In some cases, distribution of the stock of a subsidiary to the shareholders of the holding company will not be feasible because it would result in the holding company being unable to service acquisition indebtedness, or to pay dividends on preferred stock which it issued for the original acquisition of the subsidiary.

tive forms of relief be provided, such as a special "rollover" or on an installment tax payment provisions.[11]

Ways and Means Committee Bill of 1974

The 1974 committee bill would have provided three possible ways in which tax relief could be obtained by individuals and corporations for divestitures made pursuant to the 1970 bank holding company legislation.

The first method provided was the tax-free spinoff, which was substantially the same as the 1956 and 1966 provisions. Under this approach the stock of a bank or nonbank subsidiary could be distributed tax-free to the shareholders of the bank holding company (either in redemption of some of the holding company's own stock or without any surrender by the holding company's shareholders).

The second method provided was a so-called "rollover" treatment. Under this approach the tax on any gain from a sale pursuant to the divestiture would be deferred if the proceeds of the sale were reinvested in qualified replacement property.[12]

The third method provided was an installment tax payment provision. Under this approach a bank holding company selling either bank or nonbank property would have been permitted to pay the tax (without interest) on the gain realized on the sale in equal annual installments over a period beginning in the year after the disposition and ending no later than 1985.

All of these methods would be available with respect to assets acquired by the bank holding company on or before July 7, 1970 (the date on which the Senate Banking and Currency Committee announced that it would report out a bill dealing with one-bank holding companies). The relief would also be available with respect to certain substituted property acquired after such date if the property was received in certain tax-free transactions. This would apply to type "A" reorganizations (mergers) and type "B" reorganizations (stock for stock exchanges) as well as recapitalizations and mere changes in identity.

Ullman Bill (H.R. 11997)

Under the Ullman bill, two possible ways are provided so that tax relief can be obtained by individuals and corporations with respect

[11] In addition to the tax relief extended under present law to divestitures required under the Bank Holding Company Act, nonrecognition of gain or loss treatment has been provided with respect to certain exchanges required under Federal Communications Commission policies (sec. 1071) and certain exchanges or distributions made in obedience to orders of the Securities and Exchange Commission (sec. 1081).

[12] Under the 1974 committee bill, the reinvestment had to be in property which was not subject to the divestiture requirements of the Bank Holding Company Act, i.e., bank property in the case of a company continuing to be a bank holding company or nonbank property in the case of a company ceasing to be a bank holding company. If the reinvestment were in property, the tax basis of such property was required to be reduced for the amount of gain not recognized; first as to inventory, second as to accounts and notes receivable, and third as to depreciable property. If reinvestment were in stock of a subsidiary, the 1974 committee bill provided for what is referred to as the so-called "double basis" adustment; that is, both the tax basis of the stock and the underlying assets of the subsidiary were to be reduced.

These basis reduction rules were intended to preclude permanent deferral of the tax attributable to a divestiture sale. Thus, the deferred taxes would be recaptured when there was a disposition of the reinvestment property or through reduced depreciation deductions for the reinvestment property. However, these basis reduction requirements may result in the conversion of capital gains into ordinary income and provide tax deferral only for the short time required for inventory and receivables turnover.

to divestitures made pursuant to the 1970 bank holding company legislation. The first method is the so-called "spinoff," under which either stock of a bank or nonbank subsidiary could be distributed without the recognition of gain to the shareholders of the bank holding company. This method also includes distributions in redemption of some of the bank holding company's own stock.

The second method is the installment tax payment approach under which a bank holding company selling either bank or nonbank property would be permitted to pay the tax on a gain realized on the sale in installments over a period of time.

The Ullman bill does not include the "rollover" treatment provided in the 1974 committee bill. However, as described below, certain modifications are provided in the provisions of the 1974 committee bill to make the other two methods more viable alternatives in obtaining appropriate tax relief. In this respect, the principal change provides a minimum period of 10 years for the installment payment of income tax attributable to a gain realized from the disposition of property by a bank holding company.

Subject to these modifications and certain other changes (described below), the spinoff and installment payment methods are essentially the same as would have been provided under the 1974 committee bill with respect to these methods. However, the Ullman bill is generally limited in scope to provisions of general applicability and does not include provisions relating to all of the specific cases which may be brought to the committee's attention. (Specific cases are set forth below, which the committee may wish to consider for purposes of providing special rules where the facts and circumstances of a particular case fall outside the scope of the general rules.)

The principal provisions of the Ullman bill, as contrasted with the 1956 and 1966 tax relief provisions or the applicable provisions under the 1974 committee bill, are as follows:

(1) *Period for installment payment of tax.*—The 1974 committee bill would have permitted a bank holding company selling either bank or nonbank property to pay the tax (without interest) on the gain realized on a sale in equal annual installments over a period beginning in the year after the disposition and ending no later than 1985.

The Ullman bill provides for a minimum installment period of not less than 10 years. Thus, in the case of a sale in 1980, the installment period would be available until 1990 (rather than 1985 as under the 1974 bill). However, under the Ullman bill, interest would be payable with respect to installment payments made after 1985.

(2) *Requirement for pro rata distributions.*—In general, the Ullman bill (and the 1974 committee bill) provides that distributions made under the spinoff method are required to be pro rata among all shareholders. However, under the Ullman bill a distribution which is pro rata with respect to common shareholders would be permitted. In addition, in the case where the distribution is in exchange for stock (i.e., a redemption of the bank holding company's own stock), the pro rata requirement would be considered satisfied if the distribution is made pursuant to a good faith offer made on a uniform basis to all shareholders (including preferred shareholders) or to all common shareholders of the holding company.[13]

[13] In 1956 disproportionate distributions were permitted. In 1966 pro rata distributions were required with respect to each class of shareholders receiving distributions.

A limited exception is provided under the Ullman bill to permit disproportionate distributions where the Federal Reserve Board might require it in order that there be an effective separation of banking and nonbanking businesses, e.g., where the result of a pro rata distribution would be that the same small group of shareholders would continue their respective interests in two corporations rather than one. This exception would apply only in the case of a qualified bank holding corporation which does not have more than 10 individual shareholders. Further, the exception would apply only if the Board certifies that a pro rata distribution is not appropriate to effectuate the policies of the Bank Holding Company Act and that a disproportionate distribution is necessary or appropriate to effectuate such policies. In this case, the Board is to make such certification only after consultation with the Secretary of the Treasury or his delegate. The requirement for consultation with the Secretary or his delegate is intended to give the Treasury Department an opportunity to advise the Board with respect to tax avoidance possibilities which might result from a disproportionate distribution.

(3) *Recognition of appreciation with respect to property used to redeem stock.*—As a result of the Tax Reform Act of 1969, present law taxes any gain to a corporation which uses appreciated property to redeem its own stock (sec. 311(d)). However, a number of exceptions were provided to this rule.[14] An exception was not provided at that time for distributions required under the Bank Holding Company Act. The 1974 committee bill did not deal with this issue.

The Ullman bill adds an additional exception to the provision so that appreciation would not be recognized by a distributing corporation when using appreciated stock of a banking or nonbanking subsidiary to redeem its own stock. This exception, however, would not apply if the distributee is a tax-exempt organization.

(4) *Substituted property rules.*—As under the 1974 committee bill, the Ullman bill provides tax relief with respect to property acquired after the July 7, 1970, cutoff date if the property was received by the bank holding company in certain tax-free transactions, including type "A" reorganizations (mergers) and type "B" reorganizations (stock-for-stock exchanges) as well as recapitalizations and mere changes in identity.

(5) *Treatment of subsidiary of a bank holding company.*—In certain cases, a parent corporation may be treated as a bank holding company because its subsidiary owns stock in a bank. If the corporation owning the bank stock is a subsidiary for purposes of tax law (generally the parent corporation owns 80 percent of the voting stock), tax relief under the divestiture provisions is available because the subsidiary could be liquidated into the parent corporation without the recognition of gain, and then the parent corporation could distribute the bank stock to its shareholders without recognition of income by the shareholders. However, a company may be treated as a subsidiary of a

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[14] The rule does not apply to (1) a distribtuion in partial or complete liquidation of a corporation, (2) a distribution of stock or securities in a divisive reorganization, (3) certain complete redemptions of a 10-percent shareholder, (4) certain distributions of stock of a 50-percent controlled corporation, (5) certain distributions of stock or securities pursuant to the terms of a judgment requiring divestiture under the antitrust laws, (6) certain distributions in redemption of stock to pay death taxes, (7) certain distributions to a private foundation in redemption of stock, and (8) certain distributions by a regulated investment company in redemption of its stock.

bank holding company under the bank holding company provisions if the holding company owns 25 percent or more of its stock. Thus, in the case where a corporation is treated as a subsidiary under the Bank Holding Company Act but not under the Internal Revenue Code, bank stock owned by the subsidiary may not be distributed without the recognition of income unless it is treated as the bank holding corporation.

The 1974 committee bill did not deal with this issue.

The Ullman bill extends the tax relief provisions to distributions or sales by a subsidiary of a bank holding company. These distributions and sales would be subject to the same requirements applicable to the "parent" holding company, e.g., the Federal Reserve Board must certify that divestitive is necessary or appropriate to effectuate the policies of the Act.

(6) *Treatment of property exempt from divestiture requirements under the grandfather provision of the 1970 Bank Holding Company Amendments.*—Under the Act, an exemption is provided from the divestiture requirements for a company covered in 1970 with respect to nonbanking activities in which it was lawfully engaged on June 30, 1968. The 1974 committee bill would have extended tax relief with respect to this so-called "grandfather" property to the extent the bank holding company gave up its status under the exemption.

The Ullman bill provides a similar election for a bank holding company except that the election to forego the grandfather status would have to apply to all property coming within this exemption.

(7) *Stock not subject to divestiture under Bank Holding Company Act.*—Under 1956 and 1966 tax provisions, nonrecognition treatment was not extended to the 5 percent of the voting stock of a nonbanking company which was permitted to be retained under the Bank Holding Company Act by a bank holding company. Thus, the distribution under the spinoff method by a bank holding company of all of the stock of a wholly owned company resulted in nonrecognition treatment only to the extent of 95 percent of the distribution unless the remaining 5 percent otherwise qualified under the general divisive reorganization provisions of present law (sec. 355).

The Ullman bill (and the 1974 committee bill) permits the special tax treatment under both the spinoff method and the installment tax payment method in the case of a divestitive of all the shares, including the 5 percent of the stock which a bank holding company would have been permitted to retain if it had chosen to do so.

(8) *Disqualification of distribution for special tax treatment.*—Under the 1956 and 1966 tax provisions, nonrecognition treatment was denied to the shareholders under the spinoff method if the distributing corporation retained or transferred property as part of a plan one of the principal purposes of which was the distribution of earnings and profits of any corporation (sec. 1101(d)(1) and (2)). However, in the case of certain transfers which were contributions to capital of a corporation, the recognition treatment was limited to the portion of the distribution attributable to the transfers which resulted in a distribution of earnings and profits (sec. 1101(d)(3)).

The Ullman bill (and the 1974 committee bill) deletes the limitation on the recognition treatment in the case of contributions to capital of a corporation.

(9) *State required divestitives.*—The 1974 committee bill provided that the installment payment of tax method was also to be available in certain situations where the divestiture was compelled by State law.

The Ullman bill does not provide special rules with respect to divestitures required under State bank holding company laws.

Administration Proposal

The Treasury Department made the following specific recommendations [15] in its testimony before the committee on January 27, 1976:

(1) Retain the spinoff provisions contained in the 1974 committee bill with the following changes:

(*a*) Permit nonpro-rata distributions.

(*b*) Provide an exception to section 311(d) so that spinoffs by a bank holding company using appreciated stock or other property to redeem its own stock will not result in recognition of gain by the company.

(2) Delete the rollover provisions because they are undesirably complex and are also unnecessary as a practical matter.

(3) Retain the installment payment (or deferred payment) provisions with the following changes:

(*a*) Provide the same fixed deferral period for payment of the tax on any gain resulting from a required sale, regardless of when the sale occurs. A fixed period of eight or perhaps ten years was recommended.

(*b*) Relax the limitations of code section 453 so that if a divestiture occurs through an installment sale, the gain may be reported as provided in section 453.

Proposals Submitted by Interested Persons to Committee

The following is a general summary of the views submitted to the committee on behalf of interested persons at the public hearing conducted on January 27, 1976, and in subsequent correspondence to the committee. Since many of the comments expressed support for tax relief in the case of divestitures under the Bank Holding Company Act generally or for specific situations, which are covered under the Ullman bill, the summary is limited to those specific proposals which are not included in the Ullman bill. Initially, however, a list is set forth of those supporting some relief or whose recommendations are generally covered in the Ullman bill. A separate section is set forth dealing specifically with the rollover approach which is provided under the 1974 committee bill but which is not included in the Ullman bill and not supported by the Administration. It should be noted in this regard that many of the witnesses who commented about the rollover approach have indicated an installment tax payment approach is preferable to the rollover approach as provided under the 1974 committee bill.

[15] The Administration proposal of 1973 would have provided two methods of obtaining tax relief consisting of a spin-off method and a rollover method.

A. Those supporting tax relief and whose recommendations are covered under the Ullman bill[16]

Association of Bank Holding Companies, represented by Donald L. Rogers, president

C.I.T. Financial Corporation, represented by Alan B. Lerner, general counsel

GATX Corporation (statement submitted)

The Hardaway Co., represented by Gerald D. Morgan

International Bank of Washington, represented by Guy Martin

The Jacobus Company, represented by Charles D. Jacobus, president

Lykes Bros. Inc. (letter submitted by Nathan B. Simpson)

Lykes-Youngstown Corporation, represented by S. W. Murphy

Motor Finance Corporation, represented by Robert S. Corbin, president

Powell Lumber Company, represented by John C. Camp

The Republic of Texas Corporation, represented by James B. Berry, president

The Sperry & Hutchinson Company, represented by Peter A. Cooper, executive vice-president

Signal Companies, Inc. (statement submitted)

Warner Communications, Inc. (statement submitted)

World Airways, Inc., represented by Mac Asbill, Jr.

B. Other recommendations

C.I.T. Financial Corporation, represented by Alan B. Lerner, General Counsel.

Summary of facts.—C.I.T. Financial Corporation is a diversified corporation engaged in consumer and industrial financial services, banking, insurance, manufacturing, and merchandising. Its stock is listed and widely held. C.I.T. is engaged in banking by reason of its ownership of the National Bank of North America, which it acquired in 1965. Its manufacturing and merchandising businesses are principally carried on by All-Steel, Inc. (a manufacturer and distributor of metal office furniture and electrical fittings), Gibson Greeting Cards, Inc. (a manufacturer of greeting cards, party goods and other paper products), and Picker Corporation (a manufacturer of a wide variety of medical diagnostic and treatment equipment and apparatus).

The bulk of C.I.T.'s activities are banking or closely related to banking, and C.I.T. anticipates that it will remain a bank holding company. Most of its manufacturing and other nonbanking companies were acquired before June 30, 1968, so that divestiture of these companies is not presently required because these activities are grandfathered under the 1970 amendments. However, one of the manufacturing companies acquired a subsidiary after June 30, 1968, and that subsidiary must be divested on or before December 31, 1980.

Recommendations.—If, before a sale, a certification from the Federal Reserve Board has been obtained to the effect that the sale is

[16] Additional specified recommendations not of a general nature of those listed which are not included in the Ullman bill are set forth in "B" and "C" below.

necessary or appropriate to carry out the policies of the bank holding company legislation, a final certification (that the divestitures have occurred) from the Board should not be required.

If, however, it is desired to retain some kind of final certification, the requirement is unworkable when applied to divestitures of grandfathered subsidiaries if some but not all of these subsidiaries are to be divested. In this case, it will not be known when the *last* sale has occurred until the divestiture period has expired at the end of 1980. A fixed date, such as December 31, 1981, should be substituted as the required date for the final certification.

The Hardaway Co.; represented by Gerald D. Morgan

Summary of facts.—The Hardaway Company has for many years been engaged primarily in the construction business. It presently owns slightly over 7 percent of the stock of a national bank which was acquired before July 7, 1970. It appears likely the bank will create a 100-percent ownership bank holding company which will exchange all of its stock for all of the stock of the bank, as a result of which Hardaway will acquire, after July 7, 1970, a 7-percent stock interest in the new bank holding company. This transaction will occur in a type "B" reorganization (a stock for stock exchange).

Recommendations.—It should be made clear that the July 7, 1970, cutoff date is satisfied in the case where a company is subsequently determined to be a bank holding company by the Federal Reserve Board if the circumstances before the cutoff date are exactly the same as at the time of the determination by the Board.[15]

International Bank of Washington, represented by Guy Martin

Recommendation.—Tax relief legislation for required bank holding company divestitures should apply to any company which registered as a bank holding company within 180 days of enactment of the 1970 amendments, and if the Federal Reserve Board finds that on the effective date of the 1970 amendments a company controlled other banking assets in addition to those for which registration was made, tax relief should also be accorded to any divestiture required by such Federal Reserve Board finding.

Lykes Bros. Inc., (letter submitted by Nathan B. Simpson)

Summary of facts.—Section 4(c)(ii) of the Bank Holding Company Act of 1956 provides an exception to the divestiture requirements for a company covered by the 1970 amendments if more than 85 percent of the voting stock was collectively owned on June 30, 1968, and continuously thereafter, by members of the same family (or their spouses) who are lineal descendants of common ancestors. Lykes Bros. Inc. is a Florida corporation which is a bank holding company exempt from divestiture requirements under this provision.

Recommendation.—If a company is willing to forego its exempt status as a "family owned" holding company, divestitures by it should be afforded the same tax relief as otherwise provided.

[15] Generally, it is the position of the Federal Reserve Board that a determination relating to the status of a company as a bank holding company will be retroactive only when the company directly owned as much as 25 percent of a bank. A finding that a company is a bank holding company because of its "controlling influence" is not given retroactive effect. (Federal Reserve Order of January 15, 1976, relating to Orwig and Co., Inc., and *Perpetual Corp.-Pierce National Life Insurance Co.*, 1973 Federal Reserve Bulletin 218.) In most cases, the prospective determination of status as a bank holding company results in the denial of grandfather privileges under the Bank Holding Company Act.

Lykes-Youngstown Corporation, represented by S. W. Murphy

Summary of facts.—This corporation is a bank holding company by virtue of the fact that one of its subsidiaries owns 25 percent or more of the voting stock of a national bank.

Recommendation.—Distributions should be permitted to be made on a non pro rata basis.

The Republic of Texas Corporation, represented by James D. Berry, president

Summary of facts.—The Republic of Texas Corporation is a registered bank holding company which owns, either itself or through a variety of subsidiaries, interests in a number of banks and also nonbanking assets connected with a wide variety of other activities.

The corporation became a bank holding company during 1974 in a tax-free merger in which it succeeded to the controlling interests in the Republic National Bank, the Oak Cliff Bank and Trust Company, and certain nonbanking assets owned by the Howard Corporation, which is a trusteed affiliate. Because it became a bank holding company in 1974, it is required to divest itself of its nonbanking assets by May 9, 1976. However, it has applied to the Federal Reserve Board for a one-year extension to May 9, 1977. In addition, the FRB has indicated that it will require this taxpayer to divest itself of some of its minority interests in banks. It has in fact already made some divestitures required by the Bank Holding Company Act. It is indicated that it will probably be necessary to make piecemeal dispositions of the wide variety of prohibited assets.

Recommendations.—(1) The requirement of a second certification after all divestitures have occurred is unnecessary and should therefore be deleted.

(2) The tax relief for sales of banking or of non-banking assets should not be mutually exclusive, but such relief should be available for all divestitures required under the Act since the same adverse tax consequences will otherwise follow divestiture regardless of the nature of the property divested.

Taxation with Representation, represented by Thomas J. Reese

Recommendations.—Taxation with Representation does not, in general, favor granting tax relief for bank holding company divestitures particularly because of the retroactive effect this legislation would have. Specifically, it was recommended:

(1) The rollover provisions should be deleted.

(2) No more than 10 years should be allowed for the payment of taxes under the installment payment alternative.

(3) There should be no expansion of any of the tax relief alternatives, since they are excessively generous as they now stand.

Warner Communications, Inc.

Summary of facts.—Warner is a one-bank holding company by reason of its ownership of approximately 60 percent of the stock of Garden State National Bank, Paramus, New Jersey. In 1971, in conformity with the provisions of the 1970 amendments. Warner filed an irrevocable election with the Board of Governors of the Federal Reserve System to cease being a bank holding company by divesting itself of all elements of control over such bank by January 1, 1981.

Recommendations.—(1) The substituted property rules should include stock received in a tax-free organization of a corporation (under sec. 351) after the July 7, 1970, cutoff date to the extent the property exchanged for such stock satisfied the cutoff date.

(2) It should be made clear that successive tax-free transactions or exchanges are permitted under the substituted property rules.

(3) It should be provided that divestiture would not disqualify a pre-divestiture reorganization (qualifying under the substituted property rules) on grounds that "continuity of interest" did not continue after the divestiture.

(4) It should be provided that distributions may be pro rata with respect to a class of stock or securities rather than being pro rata with respect to all shareholders.

C. Recommendations relating to the "rollover" approach

C.I.T. Financial Corporation, represented by Alan B. Lerner, General Counsel.

Summary of facts.—Set forth in "B" above.

Recommendations.—(1) A qualifying replacement investment should be allowed to be made either by a subsidiary or by the bank holding company itself, regardless of which entity had made the required divestiture.

(2) A tax-free acquisition should be eligible for treatment as a qualifying replacement.

(3) A bank holding company required to make divestitures should be entitled to choose between the rollover alternative and the installment tax payment alternative on a sale-by-sale basis.

GATX Corporation (statement submitted)

Summary of facts.—GATX is a holding company which is primarily engaged through its subsidaries in a variety of transportation-related activities. The major activity is the ownership and leasing of a fleet of approximately 63,000 freight cars, principaly tank cars. Other activities include the operation of public terminals in various localities of the United States and abroad for the storage and handling of a variety of liquid and dry bulk commodities, and the ownership, chartering and operation of a 47-vessel fleet of ocean-going vessels.

GATX also owns directly 84 percent of the outstanding common stock of LaSalle National Bank of Chicago, Illinois. GATX acquired its stock ownership in LaSalle through a stock-for-stock exchange in 1968 and 1969, in which GATX exchanged shares of its convertible preferred stock for the common stock of LaSalle. The preferred stock is presently redeemable by GATX at a price which the corporation estimates would generate a gain to the shareholders of $16.5 to $21.5 million. (GATX also presently has outstanding an option for two individuals to purchase its shares of LaSalle stock. This option will terminate on December 31, 1976.)

Recommendations.—(1) GATX believes that the tax relief should include a "rollover" method.

(2) GATX anticipates that in the event it uses the rollover tax relief alternative, if this is provided, it would use the proceeds from its sale of the LaSalle stock to purchase stock in one or more corporations owning substantial amounts of depreciable heavy equipment.

The double basis adjustment required under the rollover alternative in the 1974 committee bill would result in the conversion of the capital gain not recognized on the disposition of the LaSalle stock into ordinary income because of the reduced depreciation deductions which would be allowable on the equipment of the acquired company. GATX therefore believes that the double basis reduction is neither equitable nor necessary to effect the purpose of tax relief for such divestitures, and it is recommended that the basis adjustment to the assets of the acquired company be eliminated.

The Republic of Texas Corporation, represented by James D. Berry, President

Summary of Facts.—Set forth above.

Recommendations.—(1) With respect to the rollover method, it should be provided that the purchase of replacement property can be made either by the bank holding company or its subsidiary.

(2) The installment payment or rollover alternatives should be available on a sale-by-sale basis.

The Sperry & Hutchinson Company, represented by Peter A. Cooper

Recommendation.—The double basis adjustment feature of the rollover alternative is inequitable and should be eliminated, or, at the very least, substantially modified. For example, it could be modified so that the asset basis reduction would be applied first to nondepreciable capital assets, then to depreciable assets, and finally, to ordinary income assets, such as inventory.

Signal Companies, Inc.

Summary of facts.—In 1967, the Signal Oil and Gas Company (now Signal Companies, Inc.) acquired the stock of Arizona Bancorporation in exchange for preferred stock of Signal. The name of Arizona Bancorporation was changed to Signal Equities. Signal Equities was a holding company whose principal investments were substantial stock interests in The Arizona Bank, a finance company and two manufacturing companies. On September 30, 1970, Signal sold its interest in Signal Equities for cash and reinvested the proceeds in other wholly-owned subsidiaries of Signal. The sale was made in anticipation of the enactment of the one-bank holding company legislation pending a that time, which would have made divestiture mandatory. Taxable gain of $7.5 million was realized on this transaction, comprised of $5.1 million from the sale of the banking assets and $2.4 million from the sale of the nonbanking assets.

Recommendation.—It is appropriate to offer nonrecognition treatment, similar to that of section 1033, where the proceeds from a divestiture sale are reinvested in other businesses.