[COMMITTEE PRINT]

SUPPLEMENT TO DESCRIPTION OF TECHNICAL AND MINOR BILLS HEARD BY THE COMMITTEE ON WAYS AND MEANS ON AUGUST 26, 1976

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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I. INTRODUCTION

This pamphlet supplements the August 24, 1976, pamphlet which describes the technical and minor bills heard by the Committee on Ways and Means on August 26, 1976.

The testimony presented to the committee is summarized bill-by-bill in bill number order.

In accordance with the decision of the committee, this pamphlet also includes summaries of H.R. 11486 (relating to private operating foundations) and H.R. 14717 (relating to pension, etc., plan benefits used as loan security).

II. SUMMARIES OF TESTIMONY, ETC.

1. H.R. 1143—Mr. Waggonner

Refund of Alcohol Taxes and Duties After Loss Due to Disasters or Damage

No testimony was submitted on this bill.

2. H.R. 8643—Mr. Conable

Tax Treatment of Home Brewers

Summary of testimony

Jack Leonard, President, Vynox Industries, Inc., Rochester, N.Y.: Supports the bill. Notes that present law permits wine to be produced without tax for personal use, and urges similar treatment for beer. Vynox manufactures kits for home production of beer. Notes the anomaly that these kits may be manufactured and sold but that purchasers may not legally use these kits to brew beer even for their personal use. Maintains that enactment of bill would not have negative impact on beer producers for regular retail markets.

Does not object to Justice Department suggestion that 20-gallon limitation of beer on hand be increased to 30 gallons.

3. H.R. 8989—Mr. Ullman

Tax Treatment of Indian Tribes and Alaskan Native Villages

Summary of testimony

Richard Schifter (Washington, D.C.), representing the Oglala Sioux Tribe, the Rosebud Sioux Tribe, and the Cheyenne River Sioux Tribe, all of South Dakota; the Nez Perce Tribe of Idaho; the Metlakatla Indian Community of Alaska; the Salt River Pima-Maricopa Indian Community, and the Hulapai Tribe of Arizona; the Pueblo of Laguna of New Mexico; the Seneca Nation of New York; and the Association on American Indian Affairs, Inc.: Supports the bill, to give Indian tribal governments tax treatment similar to that which non-Indian governments (State and local governments) now receive. Notes that, "within the last 15 years, Congress has enacted many laws which have given Indian tribes the substance as well as the form of self-government." Notes that tribal governments last year raised almost $10 million in local taxes.

Does not object to Treasury Department position that benefits of bill be restricted to those tribes performing substantial governmental functions and that specific criteria be included for determining what constitutes performance of substantial governmental functions. Also

does not object to restricting proceeds of industrial revenue bonds of a tribe to use within that tribe's reservation territory.

Owen Panner, representing Confederated Tribe, Warm Springs Reservation, Oreg.: Supports the bill, and joins in statement by Richard Schifter. His tribe's governmental functions "include law and order, courts, municipal branches of all sorts. The tribe operates its own saw mill, plywood plant, timber farms, and engages in many activities, including resort activities."

Suggests that "while all the funds [proceeds of industrial revenue bonds] should be used for construction on the reservation," the limitation should permit "some incidental activities all off the reservation." For example, the restriction should permit establishment of a nuclear electric generating plant on the reservation and production of electricity for distribution off the reservation.

Urges that, in order to receive benefits under the bill, a tribe be required to perform governmental functions, but suggests that the word "substantial" not be used, so as to permit a tribe that now performs "very minor governmental functions" to be aided by the bill so that it "could do a better job." Agrees, however, that "the practical determination by the Treasury Department may take care of it."

Agrees with Treasury Department that recognition of tribes be a function of the Interior Department and not of the Treasury Department.

Emil Farve, representing Chickasaw Nation, Okla.: Supports the bill. Urges that benefits of the bill not be limited to activities on Indian reservations, since there is only one reservation in Oklahoma. The tribes perform governmental functions for their members (such as providing housing, a sewer system, delivery of social services, and health care) and work with local governments.

Carolyn Warner, Superintendent of Public Instruction, State of Arizona: Supports the bill, particularly the provision which would allow Indian tribal governments to issue tax-free development bonds.

Richard Anthony Baenen (Washington, D.C.), representing the Confederated Salish and Kootenai Tribes of the Flathead Reservation, Montana; the Three Affiliated Tribes of the Fort Berthold Reservation, North Dakota; the Hoopa Tribe of the Hoopa Valley Reservation, California; and the Arapahoe Tribe of the Wind River Reservation, Wyo.: Supports enactment of the bill "without qualification". Notes that:

> Indian tribes, to the extent they have available funds, provide services identical to many of those provided by Federal, State, and local governments. For example, in fiscal year 1974 the Tribal budget of the Confederated Salish and Kootenai Tribes of the Flathead Reservation was $4,365,887.00. The expenditure of these tribal funds included appropriations for law and order, including a court system, community services, including health care, special assistance (burials, fires, welfare), employment assistance, housing, support of tribal projects, consisting of Indian community events, and the administration of programs unique to tribal government.

Considers as "the single most important provision of the bill," the authority to issue tax-exempt obligations.

Opposes Treasury Department suggestion that the bill's benefits apply only to tribes performing "substantial" governmental functions. Acknowledges that the Treasury Department's concern may be legiti-

mate, but maintains that such a requirement "may have the effect of precluding 'have not' Indian tribes from the benefits of the act, including the authority to issue tax exempts, thereby consigning them to the 'have not' status, which they could escape if revenues could be generated by their taking advantage of the provisions of the act."

Lucy Covington, Chairperson of Colville Business Council, Confederated Tribes of the Colville Indian Reservation, Wash.: Supports the bill, especially the provision permitting tribes to issue development bonds. Believes that "other local governments should not enjoy other tax advantages not available to our reservation government."

Eugene O. Parker, Chairman of Makah Tribal Council of the Makah Indian Reservation, Wash.: Supports the bill. States that "Indian tribes should be entitled to the same tax status as is enjoyed by other governments."

Ramona Bennett, Chairwoman of Tribal Council of the Puyallup Tribe of Indians, Medicine Creek Treaty Nation, Takoma, Wash.: Supports the bill. States that the "Puyallup tribe has in recent years developed an Indian school, a day care center, an Indian community clinic, and programs for fisheries management, economic development, job referral, alcoholism treatment and counseling, housing assistance, legal assistance, law enforcement and a judicial system." Especially interested in section 7 (allowing income tax deduction for taxes paid to the tribe) and sections 8 and 12 (allowing deductions for charitable contributions to the tribe).

Joseph DeLaCruz, President, Quinault Indian Nation, Taholah, Wash.: Supports the bill, which will "put Indian tribes, which are providing normal governmental services to residents of their territories on a more equal footing with other units of government. * * * The Quinault Indian Nation provides its residents with: Fire protection, legal aid, ambulance service, law enforcement, a court system, water, sewerage, television transmission, resource development and enhancement in the area of fisheries and timber, and social services. The Quinault Indian Nation enforces regulations having to do with such activities as land use, building construction, health inspection, business regulation, and licensing."

Is especially concerned with supporting the following provisios of the bill: section 5 (exception from income of interest on bonds issued by the tribe), section 7 (allowing deduction of taxes paid to the tribe), and sections 8 and 12 (allowing deductions for contributions to the tribe).

Christian Penn, Sr., Chairman, Quileute Tribal Council, La Push, Wash.: Supports the bill. States that the tribe "has recently undertaken to provide a full range of Governmental Services on the Quileute Indian Reservation, including law enforcement, water, sewage and garbage services, business licensing and regulations, land use planning, housing, fisheries regulations and enhancement, and social and health programs."

Especially interested in section 5 (issuance of tax-free municipal bonds), section 7 (deduction of taxes paid, and sections 8 and 12 (deduction of charitable contributions).

Small Tribers Organization of Western Washington, representing Twenty-three Indian Tribes, Sumner, Wash.: Supports the bill. States

that the "tribes exist independently as sovereign entities, and have many of the same functions as do municipal, State, and territorial government. Tribes conduct annual general meetings and regular council meetings to perform ongoing legislative duties. They elect officers, and carry out responsibilities of government of their reservations and members. The tribes provide their constituents many facilities, among them health diagnosis, law enforcement, land use planning, nautral resource development, fishery enhancement, legal services, tribal enterprises, employment counselling, and housing development."

Especially interested in section 5 (allowing issuance of bonds upon which interest would be excluded from taxation), section 6 (allowing for exclusion of scholarship and fellowship grants from gross income), section 7 (allowing tax deduction in an amount equal to amount paid in certain taxes to the tribes), and sections 8 and 12 (allowing deductions for charitable contributions to the tribe).

New Mexico Indian Tax Study Commission representing the Nineteen Pueblo Tribes and the Mescalero Apache Tribe of New Mexico, Albuquerque, N.M.: Supports the bill. States that the bill "not only affords the tribe an economic boost, but it also goes a long way to a stronger acknowledgement of the tribes' governmental status. Such an acknowledgement is a necessary aid in developing Tribal Self-Determination at both an economic and governmental level."

Charles E. Trimble, Executive Director, National Congress of American Indians, Washington, D.C.: Supports the bill. Believes enactment of the bill will greatly increase the prospects for future economic self-sufficiency of Federally-recognized Indian tribes, and that this measure will remove certain barriers which have impeded tribes in the exercise of essential governmental powers, particularly those made possible through the enjoyment and use of tribal revenues.

Objects to Administration's proposal to change definition of "recognized Indian Tribes" to "those performing substantial governmental functions," and states that no criteria and no definition of "substantial" are offered.

Opposes Administration's proposed definition because of its restrictive nature and because of the inadvisability of creating another category of "recognized Indian Tribes," because those Tribes not performing substantial governmental functions at this time would be excluded from the jurisdiction of the bill.

Robert M. Brandon and Robert S. McIntyre, Public Citizens' Tax Reform Research Group, Washington, D.C.: Support the "broad concept" of the bill, with "certain reservations." Are concerned that the bill might involve significant revenue losses and that it might constitute "a broad structural or major administrative change in the tax laws."

Additional information

On reexamination, the staff has concluded that the bill is likely to result in a revenue loss of less than $5 million per year. (The August 24 pamphlet had set forth an estimated loss of $1 million per year from section 7 of the bill, with no estimate as to the effect of the other provisions.)

4. H.R. 11134—Mr. Steiger (Wisconsin)

Constructive Sale Price for Excise Tax Purposes

Summary of testimony

Frank J. Hasselman, President of the LaHass Corp., St. Paul, Minn., representing the Truck Equipment & Body Distributers Association, Cincinnati, Ohio: Supports the bill. Regards it as of great importance to his industry, which installs bodies and accessory items on the truck chasis that are manufactured by the companies generally regarded as truck manufacturers. Maintains that Internal Revenue Service's method of determining the tax base when a company in his industry adds a body to a truck is excessively complicated.

States that the effect of the current Service approach is to impose the tax on the greater of (1) the company's cost or (2) 75 percent of what the company charges. As a result, if the company incurs additional costs (thereby reducing or eliminating its profit on a particular transaction), then it may find that the tax base on that transaction has been increased over the amount that was taken into account when the contract to add the body was entered into. Effect of the bill would be to remove the cost of the particular company as an element in determining the tax base.

Urges that the percentage method of determining the constructive sale price should be established on a nationwide basis, rather than having each excise tax district derive its own allowable percentage.

John A. Hazelwood and David Brenner, representing Brenner Tank Co., Inc., Fond du Lac, Wis., and the Truck Body and Equipment Association: Support the bill. State that the use of the "cost floor doctrine" formulated by the Internal Revenue Service causes the various manufacturers in the highly competitive truck tank industry to pay differing amounts of excise tax on competing products which are sold for the same retail price. Argue that the cost floor rule is contrary to the legislative intent of Congress in enacting Code section 4216. Maintain that the cost floor rule creates "a giant administrative headache" for both manufacturers and the IRS since it is unclear what costs are to be allocated to each manufactured product subject to the tax. Also point out that use by the IRS of the cost floor as the basis for subsequent determinations of the tax is inequitable because the manufacturer is caught in the middle—it pays the tax itself if there is a deficiency and it must pass on any refund of the tax to the purchaser of the taxable product. Urge that the use of the cost floor approach for manufacturers excise taxes be prevented by statute, except in cases where the manufacturer itself uses a taxable item.

Have "no objection to the 75 percent rule or even to a higher percentage."

Note that basing the excise tax on costs under the cost floor doctrine used by the IRS creates a regressive excise tax situation through which a manufacturer's excise tax is increased as its profits decrease.

Body and Equipment Association, Inc.: Strongly supports the bill. Notes that the cost floor rule has led to increased complexity in computing and administering the manufacturers excise tax and has created competitive discrimination in many cases. Maintains that adoption

of the bill would eliminate the cause of much of the complexity in the manufacturers excise tax and contribute to its more equitable application by prohibiting the IRS from using cost as a factor in computing a constructive sales price for manufacturers excise tax purposes.

Ivar Sorensen, Finance Control Manager of The Polar Co., Holdingford, Minn.: Opposes the bill. Believes that this excise tax should be repealed and that amendments of it would be confusing and counterproductive. Questions the appropriateness of the retroactive effective date (sales after December 31, 1975) of the provision.

5. H.R. 11436—Mr. Mikva

Widow's Allowances

Summary of testimony

Austin Fleming, representing American Bankers Association: Strongly supports the bill, to provide uniform income tax rules for the treatment of widow's and dependent's support distributions made by an estate. States that the bill will provide simplification and permit an orderly administration of estates.

6. H.R. 13532—Mr. Pickle; H.R. 14857—Mrs. Keys

Tax Exemption for Nonprofit Companies That Insure Shares In Credit Unions

Summary of testimony

Buford Lankford (President, Texas Share Guaranty Credit Union), Ivan Nestingen, and Donald Melvin, representing Credit-Union National Association, Inc.: Support the bill. Believe that the bill is needed to put State-chartered organizations which insure shares in State-chartered credit unions on an equal footing with certain State-chartered agencies which insure savings and loan associations, mutual savings banks, and certain cooperative banks. Urge that these insuring agencies should not be taxable because all they provide are benefits for members, all of whom are tax-exempt credit unions. Maintain that the existence of State-chartered deposit insurance companies, which compete with tax-exempt Federal agencies, is essential to preserve the dual chartering system for credit unions. Assert that current law is unclear and there is a need for uniformity. Would also favor a bill of the type proposed to cover organizations which insure shares in both savings and loan associations and credit unions.

R. Earl O'Keefe, Chairman, Bankers Committee to Eliminate Favoritism to Credit Unions: Supports the bill. Urges that the bill be interpreted as providing Federal income tax exemption solely for the insuring organizations and not for commercial banks or other financial institutions purchased by credit unions.

Robert M. Brandon and Robert S. McIntyre, Public Citizens' Tax Reform Research Group, Washington, D.C.: Urges the consideration of these bills be put off until the Financial Institutions Subcommittee has completed its investigation of State-chartered deposit insurers. Notes that a blanket Federal tax subsidy might result in substantial

damage to the integrity of the banking system if State regulation is inadequate.

7. H.R. 13649—Mr. Pickle

Interest Rate Adjustment on Retirement Plan Savings Bonds

Summary of testimony

Hon. J. J. Pickle (U.S. Cong., Texas): Supports the bill because it would enable investors in retirement plan savings bonds to earn the same rate of interest on their outstanding bonds as do investors in Series E savings bonds. The adjustment would be made semi-annually beginning September 30, 1976. Believes that in the absence of this adjustment in the interest rate, investors will turn to various retirement plan schemes offered in the private sector. Any net reduction in Treasury sales of retirement plan bonds will increase the amount of money that must be raised in the money market generally.

8. H.R. 14135—Mr. Gibbons

Publication of Statistics of Income

Additional information

A similar proposal has been agreed to as section 2123 of H.R. 10612.

III. ADDITIONAL BILLS

A. H.R. 11486—Mr. Burleson and Mr. Jones

Tax Treatment of Private Operating Foundations

SUMMARY

The bill deals with two aspects of the tax treatment of private operating foundations. Under present law, operating foundations of a certain type are required to make charitable expenditures of not less than about 4 percent (4.5 percent for 1976) of their "noncharitable" assets, i.e., those assets which are not used in the active conduct of charitable activities. The bill would reduce the required expenditure level to 3 percent for the next 10 years. (An indirect effect of sec. 1303 of H.R. 10612 is to reduce this charitable expenditures rate to 3⅓ percent for 1976 and future years.) In addition, present law imposes a 4-percent tax on the investment income of all private foundations. The bill would reduce the tax on investment income—for operating foundations alone—to 2 percent.

Present law

Charitable expenditures

The Tax Reform Act of 1969 imposed a number of requirements and special limitations applicable to private foundations generally. In certain significant respects, however, a category of private foundations ("operating foundations") received treatment more favorable than that accorded to private foundations generally. A major area of preferred treatment is the minimum charitable expenditure requirements.[1]

A private foundation that is not an operating foundation must spend for charitable purposes each year the greater of (1) its income for that year or (2) its "minimum investment return" (i.e., approximately 6 percent of the value of its noncharitable assets) for that year. An operating foundation is not held to such high statutory charitable expenditure requirements. In order to qualify as an operating foundation, the organization must spend "substantially all" of its income each year directly for the "active conduct" of its exempt activities. In addition, on operating foundation must meet one of three tests. One of these three alternatives is that the operating foundation normally spends, for the active conduct of its exempt activities, an amount not less than two-thirds of the "minimum investment return" described above. In other words, the operating foundation normally must spend for such active conduct at least approximately 4 percent of the value of its noncharitable assets.

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[1] The other major area is that of charitable contribution deductions. Operating foundations are generally classed together with "public charities" in that they are eligible to receive charitable contribution deductions up to 50 percent of the donor's adjusted gross income and that they are eligible to receive contributions of "capital gain property" without reduction of the amount of the charitable contribution deduction.

Tax on investment income

In addition, the Tax Reform Act of 1969 imposed a 4-percent tax on the net investment income of all private foundations, including operating foundations (sec. 4940). A private foundation's net investment income is the sum of (1) its gross investment income and (2) the full amount of its net capital gains, reduced by the expenses paid or incurred in earning the gross investment income. Gross investment income includes interest, dividends, rents, and royalties, but does not include unrelated business income which is taxed under section 511.

Issue

It is argued that operating foundations typically have significant expenditure obligations imposed by the active conduct of their charitable expenditures. These expenditure obligations in many cases do not fluctuate with the current fair market value of the operating foundations' investment portfolios or other noncharitable assets. For example, operation of a home for widows and orphaned children will require certain levels of expenditures based on the needs of the people in the home at any given time. It is suggested that it is preferable that investment decisions be geared to production of the revenues necessary to cover expenditures mandated by such needs, rather than expenditures mandated by a statutory formula. On the other hand, it is recognized that the absence of any expenditure requirement might provide an inducement to creation of a portfolio of low-yield investments, combined with a deliberate choice of activities that would require relatively little in the way of current expenditures. One issue, then, is whether there should be a modification in the requirement of present law that a category of private foundations expend at least two-thirds of their "minimum investment return" (generally about 4 percent of noncharitable assets; as noted above, this is reduced to 3⅓ percent by H.R. 10612).

It was recognized in 1969 that the tax on investment income provided in the 1969 Act would be apt to produce twice as much revenue as the Service would use in administering the Internal Revenue Code provisions relating to exempt organizations. Regardless of the appropriateness of such a tax as to private foundations generally, the issue here is whether operating foundations should be required to pay a tax at the same level as private foundations generally.

Explanation of bill

The bill would reduce the required level of charitable expenditures for certain types of operating foundations (such as orphanages, nursing homes, and other extended care facilities), to 3 percent of "noncharitable assets," from its present level of approximately 4 percent (reduced to 3⅓ percent by H.R. 10612). This reduction would apply for the next 10 years.

The bill also would reduce the investment income tax for operating foundations to 2 percent, from its present level of 4 percent.

Although some prior versions of this bill would have benefited primarily about a score of "extended care facilities," led by the Myron Stratton Home (Colorado Springs, Colorado) and the Sand Springs Home (Sand Springs, Oklahoma), the bill in its present version would apply to all private operating foundations.

Prior committee action

The committee discussed this general area in 1974, but made no tentative decisions.

Effective date

The reduction in the required level of charitable expenditures for operating foundations would apply to taxable years beginning after December 31, 1975, and ending before January 1, 1986.

The reduction in the investment income tax on operating foundations would apply to taxable years ending after the date of enactment.

Revenue effect

The amendment with regard to the charitable expenditures requirement would not affect the revenues. The amendment with respect to the tax on investment income would result in an annual revenue loss of $2–3 million.

Departmental position

In a report received by the committee on March 22, 1974 (relating to H.R. 2259, 93d Cong.), the Treasury Department recommended an approach roughly similar to that in this bill.

B. H.R. 14717—Mr. Jones

Pension, etc., Plan Benefits Used as Loan Security

SUMMARY

The bill would amend both tax law and labor law to permit vested benefits earned under a profit-sharing, stock bonus, or money purchase pension plan to be used as collateral for a bank or credit union loan.

Present law

Under present tax and labor law, an employee is not allowed to assign his vested benefits under a pension, profit-sharing, or stock bonus plan unless (A) the assignment is voluntary and revocable, does not exceed 10 percent of benefit payments being made, and is not for the purpose of defraying administrative expenses; or (B) the loan is made by the plan itself under a loan program available to all plan participants on a basis which does not provide greater amounts for employees who are officers, shareholders, or highly compensated, the interest rate is reasonable, and the security is adequate.

Pension plans cannot distribute employer-derived benefits before an employee separates from service, unless the employee has died or become disabled.

Issue

Whether employees covered by money purchase pension plans (including "savings" or "thrift" plans), profit-sharing plans, or stock bonus plans should be permitted to use the vested benefits they have earned under the plans as collateral for loans from banks or credit unions.

Explanation of the bill

The bill would amend the tax law and labor law to permit vested benefits earned under a profit-sharing, stock bonus, or money purchase

pension plan to be used as collateral for a bank or credit union loan, without regard to whether or not the arrangement meets the requirements of present law.

Effective date

Date of enactment.

Revenue effect

Less than $5 million per year revenue loss.

Summary of testimony

Albert G. Fiedler, Jr., Manager (Communications Services), Standard Oil Co. of Indiana, Chicago, Ill.: Supports the bill. Employees cannot borrow from the company's thrift plan. Under the Treasury interpretation of the law, the employees cannot use their benefits as collateral for loans from third parties, but Treasury position is wrong. Prohibition on loans causes employees to withdraw from the plan and should be eliminated so that employees can be encouraged to save under the plan.

Robert M. Brandon and Robert S. McIntyre, Public Citizens' Tax Reform Research Group, Washington, D.C.: Oppose the feature of the bill which allows an employee to use tax-deferred benefits as collateral, but sees no problem in allowing such use up to the amount of the employee's contributions of taxed income.

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