[JOINT COMMITTEE PRINT]

DESCRIPTION OF TAX BILLS (S. 120, S. 1397, S. 1584, S. 1814, S. 1815, and S. 1826)

SCHEDULED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

OF THE

COMMITTEE ON FINANCE

ON SEPTEMBER 26, 1983

PREPARED BY THE STAFF

OF THE

JOINT COMMITTEE ON TAXATION

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INTRODUCTION

The bills described in this pamphlet have been scheduled for a public hearing on September 26, 1983, before the Senate Finance Subcommittee on Taxation and Debt Management.

The six bills scheduled for the hearing are: (1) S. 120 (relating to extending the allowance of the special deduction for expenses for removing barriers to the handicapped); (2) S. 1397 (relating to alternative test for qualification for the rehabilitation investment credit); (3) S. 1584 (relating to amendments to the foreign tax credit); (4) S. 1814 (relating to deduction for loss in value of bus operating authorities); (5) S. 1815 (relating to income tax exemption for certain title-holding corporations); and (6) S. 1826 ("Hunger Relief Incentives Tax Act of 1983").

The first part of the pamphlet is a summary of the bills. This is followed in the second part by a more detailed description of the bills, including present law, explanation of provisions, and effective dates.

I. SUMMARY

1. S. 120—Senators Dole, Symms, Pryor, Grassley, and others

Extend Allowance of Special Deduction for Expenses of Removing Barriers to the Handicapped

Under present law, the special deduction for qualified expenditures (up to $25,000 per year) incurred for the purpose of making facilities and certain vehicles accessible to, and usable by, handicapped and elderly individuals applies to expenses paid or incurred in taxable years beginning before 1983 (Code sec. 190). The bill would extend the existing deduction provision for two years, i.e., to qualified expenditures paid or incurred in taxable years beginning before 1985.

2. S. 1397—Senators Danforth and Eagleton

Alternative Test for Qualification for the Rehabilitation Investment Credit

Present law provides a three-tier investment credit for expenditures incurred in the rehabilitation of certain older buildings (Code sec. 48). The credit is equal to 15 percent of qualified rehabilitation expenditures in the case of buildings at least 30 years old; 20 percent in the case of buildings at least 40 years old; and 25 percent in the case of certified historic structures. Rehabilitations must satisfy certain requirements to be eligible for the credit, including a requirement that at least 75 percent of the external walls of the building must be retained as such after the rehabilitation.

The bill would provide an alternative to the 75-percent external-wall test where at least 50 percent of the external walls of the building are retained as such and certain other requirements are met. The provisions of the bill would apply retroactively to rehabilitation expenditures incurred after May 26, 1983.

3. S. 1584—Senators Danforth, Bentsen, and Huddleston

Amendments to the Foreign Tax Credit

a. Domestic loss recapture rule

Under present law, foreign losses of a U.S. taxpayer are, in effect, recaptured through the foreign tax credit limitation when the taxpayer subsequently derives foreign income (Code sec. 904(f)).

The bill would establish a domestic loss recapture rule the operation of which would be similar to the operation of the present foreign loss recapture rule. The bill would treat as foreign income a portion of domestic income derived after to a year in which a domestic loss is incurred. The effect of this recharacterization would be to increase the foreign tax credit limitation and, thus, potentially, the amount of utilizable foreign tax credits, in the later year or years.

This provision of the bill would apply retroactively to taxable years beginning after 1981.

b. Extended carryover for certain excess foreign tax credits

Under present law, excess foreign tax credits generally may be carried back for two years and carried over for five years (sec. 904(c)).

The bill would extend the foreign tax credit carryover period to 15 years for excess foreign tax credits that arise in taxable years beginning after 1978.

c. Ordering rule for foreign tax credits

Under present law, current foreign taxes are credited against U.S. tax before foreign taxes carried from other years are credited against U.S. tax (sec. 904(c)).

The bill would provide a new FIFO ordering rule for foreign tax credits. Under this rule, foreign tax credits would generally be utilized in the order in which they arose. Thus, in any taxable year, foreign tax credit carryovers would be utilized first, followed by credits for foreign taxes paid currently in the taxable year, then credit carrybacks.

The bill would also clarify the present computational rules for foreign tax credit carrybacks and carryovers.

The new ordering rule and related amendments would apply retroactively to taxable years beginning after 1981.

4. S. 1814—Senator Packwood

Deduction for Loss in Value of Bus Operating Authorities

Under present law, courts have denied an ordinary loss deduction (Code sec. 165) where the value of an operating permit or license decreased as a result of legislation expanding the number of issued licenses or permits. In 1981, as a result of the deregulation of the trucking industry, the Congress enacted a tax provision that allows trucking companies an ordinary deduction ratably over five years for loss in value of motor carrier operating authorities (sec. 266 of the Economic Recovery Tax Act of 1981). The value of bus operating authorities has diminished significantly as a result of Federal legislation that deregulated the intercity bus industry. The bill would provide tax deductions for the owners of bus operating authorities similar to that granted in 1981 with respect to motor carrier authorities.

The provisions of the bill would apply retroactively to taxable years ending after November 18, 1982.

5. S. 1815—Senator Packwood

Income Tax Exemption for Certain Title-Holding Corporations

Under present law, a corporation that is organized for the exclusive purpose of holding title to property, collecting income on the property, and distributing the net income to a tax-exempt organization is itself exempt from Federal income tax (Code sec. 501(c)(2)). The Internal Revenue Service interprets this provision to mean that the title-holding corporation may distribute income only to one or more "related" tax-exempt organizations.

The bill would exempt from Federal income tax any corporation organized exclusively to acquire, hold title to, and collect income from property and turn over all income (less expenses) from the property to one or more qualifying organizations, whether or not related. For this purpose, qualifying organizations would be (1) a qualified pension, etc., plan; (2) a governmental plan (sec. 414(d)); (3) the United States, any State or political subdivision, or any agency or instrumentality of such a governmental unit; or (4) any charitable organization (sec. 501(c)(3)).

The bill would be effective for taxable years beginning after 1983.

6. S. 1826—Senator Danforth

"Hunger Relief Incentives Tax Act of 1983"

Present law

Under present law, the amount of charitable deduction otherwise allowed for donated property generally must be reduced by the amount of any ordinary gain which the taxpayer would have realized had the property been sold at its fair market value on the date of the donation (Code sec. 170(e)). For example, a retailer which makes a charitable contribution of its inventory generally may deduct only its basis in the property.

However, under a special rule, corporations are allowed an augmented charitable deduction for qualified contributions to a public charity (other than a governmental unit) or a private operating foundation of certain types of ordinary income property donated for the care of the needy, the ill, or infants (sec. 170(e)(3)). The augmented charitable deduction allowed under this rule is generally for the sum of (1) the corporation's basis in the donated property and (2) one-half of the unrealized appreciation. In no event may the amount of the deduction exceed twice the basis of the property.

Under present law, no deduction is allowed for the value of services donated to a charitable organization. However, a taxpayer may deduct unreimbursed out-of-pocket expenses (such as fuel costs) incurred incident to the rendition of such services.

S. 1826

The bill would expand the section 170(e) augmented charitable deduction in a number of respects—

(1) *Eligible donees.*—The category of eligible donees for the augmented charitable deduction would be expanded to include governmental units.

(2) *Eligible donors.*—In the case of charitable contributions of food that otherwise qualify for the augmented charitable deduction, the bill would extend the category of eligible donors to include noncorporate taxpayers who are actively engaged in the trade or business of production or marketing of food.

(3) *Eligible contributions.*—Certain charitable contributions of transportation services for the movement of food would be treated as qualified contributions under the bill. In addition, contributions of food which a donee removes from the donor's fields ("gleaning") would be treated as qualified contributions.

The bill would provide special rules for computing the amount of the augmented charitable deduction for (1) qualified contributions of transportation services for the movement of food and (2) qualified contributions of food by a donor who is not required to and does not use inventories (e.g., farmers on cash-basis accounting for tax purposes).

The amendments made by the bill would be effective for qualified contributions made after the date of enactment.

II. DESCRIPTION OF THE BILLS

1. S. 120—Senators Dole, Symms, Pryor, Grassley, and others

Extend Allowance of Special Deduction for Expenses of Removing Barriers to the Handicapped

Present Law

Under present law, a taxpayer may elect each year to treat as a deductible expense up to $25,000 of expenditures incurred for purposes of making facilities and certain vehicles accessible to, and usable by, handicapped and elderly individuals (Code sec. 190). This provision applies to expenditures made in taxable years beginning before January 1, 1983.

The section 190 deduction was initially limited to taxable years beginning before 1980 in order to permit the Congress to review the cost effectiveness of the deduction. In 1979, the Congress made the provision applicable to taxable years beginning prior to 1983 (P.L. 96-167).

Explanation of the Bill

The allowance of the section 190 deduction for expenses of removing barriers to the handicapped and elderly (which applied for taxable years beginning before 1983) would be extended for two years, i.e., to such expenditures paid or incurred in taxable years beginning before January 1, 1985.

Effective Date

The bill would be effective on enactment. The changes that would be made by the bill would apply to taxable years beginning after 1982 and before 1985.

2. S. 1397—Senators Danforth and Eagleton

Alternative Test for Qualification for the Rehabilitation Investment Credit

Present Law

Present law provides a three-tier investment credit for expenditures incurred in the rehabilitation of certain older buildings (Code secs. 48(a)(1)(E) and 48(g)).

The rehabilitation credit is equal to 15 percent of qualified rehabilitation expenditures in the case of buildings at least 30 years old; 20 percent of such expenditures in the case of buildings at least 40 years old; and 25 percent of such expenditures in the case of certified historic structures. A certified historic structure is a building of a character subject to depreciation which is either listed in the National Register of Historic Places or located in an historic district approved by, and certified as contributing to the character of the district by, the Secretary of the Interior.

The 15- and 20-percent credits apply only to rehabilitations of commercial and industrial buildings; the 25-percent credit also applies to rehabilitations of depreciable residential property. For purposes of determining cost recovery deductions, the basis of a building with respect to which either the 15-percent credit or the 20-percent credit is allowed is adjusted for the full amount of the credit. The basis of a certified historic structure is adjusted by one-half of the allowable 25-percent credit.

Several conditions must be satisfied before a rehabilitation investment credit is allowable. The rehabilitation expenditures must exceed the greater of $5,000 or the adjusted basis of the building, and the building must have been placed in service before the beginning of rehabilitation. In addition, 75 percent or more of the existing external walls must remain in place as external walls after the rehabilitation.

Explanation of the Bill

The bill would provide an alternative test to the requirement that at least 75 percent of the external walls of a building must remain as such after completion of a qualified rehabilitation. Under the bill, the 75-percent requirement would be deemed to be satisfied if (1) 50 percent or more of the external walls are retained as such after completion of the rehabilitation; (2) 75 percent or more of the external walls are retained in place (even if not as external walls); and (3) 95 percent or more of the pre-rehabilitation internal structural framework is retained in place.

Effective Date

The provisions of the bill would apply retroactively to rehabilitation expenditures incurred after May 26, 1983.

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3. S. 1584—Senators Danforth, Bentsen, and Huddleston

Amendments to the Foreign Tax Credit

Present Law

Foreign tax credit rules generally

The United States taxes the income of U.S. citizens, residents, or corporations whether that income is from U.S. sources or from foreign sources. The foreign tax credit was first enacted in 1918 to prevent U.S. taxpayers from being taxed twice on their foreign income—once by the foreign country where the income is earned and again by the United States. The foreign tax credit is intended to allow U.S. taxpayers to offset the U.S. tax on their foreign income by the income taxes paid to a foreign country. Foreign tax credits may not be used to offset U.S. tax on domestic income.

This foreign tax credit system embodies the principle that the country in which a business activity is conducted (or in which income is earned) has the first right to tax the income arising from activities in that country, even though the activities are conducted by corporations or individuals resident in other countries. Under this principle, the home country of the individual or corporation has a residual right to tax income arising from these activities, but recognizes the obligation to insure that double taxation does not result.

Some countries avoid double taxation by exempting foreign source income from tax altogether. However, most countries, including the United States, avoid double taxation through a foreign tax credit system, providing a dollar-for-dollar credit against home country tax liability for income taxes paid to a foreign country.

General limitation

A fundamental premise of the foreign tax credit is that it should not reduce the U.S. tax on U.S.-source income. Accordingly, the Code contains a limitation to insure that the credit offsets only the U.S. tax on the taxpayer's foreign income (Code sec. 904(a)). The limitation operates by prorating the taxpayer's total U.S. tax liability before tax credits ("pre-credit U.S. tax") between its U.S.- and foreign-source taxable income.[1] Therefore, the limitation is determined by using the ratio of foreign-source taxable income to total taxable income. The resulting fraction is multiplied by the total pre-credit U.S. tax to establish the amount of U.S. tax paid on the foreign income and, thus, the upper limit on the foreign tax credit.

The following example illustrates the computation of the foreign tax credit limitation. Assume that the U.S. taxpayer has foreign-

[1] The pre-credit U.S. tax is the U.S. tax before all credits, that is, before the investment tax credit and other credits as well as the foreign tax credit.

source taxable income of $300 and U.S.-source taxable income of $200, for total taxable income of $500. Assume further that the pre-credit U.S. tax on the $500 is $230 (i.e., a 46-percent rate). Since 60 percent ($300/$500) of the taxpayer's total worldwide taxable income is from foreign sources, the foreign tax credit is limited to $138, or 60 percent of the $230 pre-credit U.S. tax. Thus, a taxpayer with foreign taxes paid in excess of $138 will be allowed a foreign tax credit of only $138 (the excess taxes paid may be carried to other years). If the taxpayer has paid less than $138 in foreign taxes, the taxpayer will have a foreign tax credit equal to the amount of the taxes paid.

Overall and per-country limitations

Historically, the foreign tax credit limitation has been determined based on either the taxpayer's total foreign income or the taxpayer's foreign income from each separate country, or both. These are known as the overall limitation and the per-country limitation, respectively.

Under the *overall method,* the taxpayer combines the income and losses from all foreign operations and allocates the pre-credit U.S. tax based upon this amount. Therefore, if (as in the example above) 60 percent of the taxpayer's taxable income is from all foreign sources combined, then the foreign tax credit is limited to 60 percent of the pre-credit U.S. tax.

Under the *per-country method,* the taxpayer determines the foreign tax credit on a country-by-country basis. Thus, the taxpayer is allowed to take a foreign tax credit for taxes paid to any particular foreign country only to the extent that the taxes paid to that country do not exceed the limitation separately determined for that country. In other words, under the per-country limitation, taxes paid to any foreign country can be used as credits only against the portion of the total pre-credit U.S. tax which is allocable to income from sources within that country.

In the Tax Reform Act of 1976, the Congress repealed the per-country limitation, making the overall limitation mandatory for most taxpayers.

Foreign loss recapture rule

Before the enactment of the Tax Reform Act of 1976, foreign losses of U.S. taxpayers generally had the effect of reducing the U.S. tax base.[2] U.S.-source income that would otherwise have been subject to U.S. tax went free of U.S. tax. In the case of a taxpayer who had foreign losses in excess of foreign income in a given year, the taxpayer could use the excess of the losses to reduce U.S. tax on U.S.-source income. Such losses reduced U.S. tax on U.S.-source income by decreasing the worldwide taxable income on which the U.S. tax was based.

Then, if the taxpayer later received income from abroad on which the taxpayer paid foreign tax, a foreign tax credit was allowed for the full amount of the foreign tax. Unless the taxpayer had an effective foreign tax rate no higher than the U.S. rate, and

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[2] The Tax Reduction Act of 1975 prevented reduction of the U.S. tax base by requiring recapture of foreign oil-related losses.

the foreign countries in which the losses originated had net operating loss carryover provisions (or some similar method of using prior losses to reduce subsequent taxable income), the taxpayer received an incidental U.S. tax benefit. This is because no U.S. tax was imposed on the subsequent year's income (to the extent of foreign taxes paid on the income), even though the earlier losses had reduced U.S. tax liability on U.S.-source income.

Example A (below) illustrates in more detail the erosion of the U.S. tax base and incidental benefit to the taxpayer that occurred when a taxpayer had foreign losses in excess of foreign income. Example A compares the U.S. tax computations for two taxpayers with the same total taxable worldwide income over a two-year period, one of whom has foreign losses in excess of foreign income in one year and one of whom does not. Example A illustrates the law prior to the enactment of the foreign loss recapture rule.

EXAMPLE A (PRE-1976 LAW)

	Year 1	Year 2	2-year total
Taxpayer 1 (overall foreign loss):			
Foreign-source income (loss)	($100)	$100	0
U.S.-source income	100	100	$200
Worldwide taxable income	0	200	200
Foreign tax (46 percent)	0	46	46
Pre-credit U.S. tax (46 percent)	0	92	92
Allowable foreign tax credit	0	[1] 46	46
Net U.S. tax	0	46	46
Excess foreign tax credit	0	0	0
Taxpayer 2 (no overall foreign loss):			
Foreign-source income (loss)	0	0	0
U.S.-source income	100	100	200
Worldwide taxable income	100	100	200
Foreign tax (46 percent)	0	0	0
Pre-credit U.S. tax (46 percent)	46	46	92
Allowable foreign tax credit	0	0	0
Net U.S. tax	46	46	92
Excess foreign tax credit	0	0	0

[1] Foreign tax credit limitation: Foreign source income ($100)/worldwide taxable income ($200) multiplied by U.S. tax ($92) equals $46.

In Example A, each taxpayer has a total 2-year U.S.-source taxable income of $200. The taxpayer with an overall foreign loss (Taxpayer 1) pays U.S. tax of $46 for the 2-year period (a 23-percent

U.S. tax rate on U.S. income)—one-half of the amount paid by Taxpayer 2, the taxpayer with no foreign loss, and one-half of the amount normally due on $200 of U.S.-source taxable income, assuming a 46-percent average U.S. tax rate.

The Congress responded to the overall foreign loss issue by including in the Tax Reform Act of 1976 a rule which requires that losses from foreign operations and, thus, the tax benefit derived from the deduction of these losses should be recaptured by the United States when the taxpayer subsequently derives income from abroad.[3]

In general, the recapture is accomplished under Code section 904(f) by treating a portion of foreign income which is subsequently derived as income from domestic sources. The portion of foreign income treated as income from domestic sources represents the overall foreign loss which in the previous taxable year may have reduced U.S. tax on income from domestic sources. The effect of the recharacterization is to reduce the foreign tax credit limitation in one or more subsequent years and, therefore, the amount of U.S. tax that can be offset by foreign tax credits in such subsequent year or years.[4]

The amount of foreign income which is treated as income from domestic sources in a subsequent year is limited to the lesser of the amount of the overall loss (to the extent that the loss has not been recaptured in prior taxable years) or 50 percent of the foreign taxable income for that year, or such larger percent as the taxpayer may choose.

For the purposes of the foreign loss recapture rule, the term overall foreign loss means the amount by which the taxpayer's (or in the case of an affiliated group filing a consolidated return, the group's) gross income from sources without the United States is exceeded by the sum of the expenses, losses, and other deductions which could be allocated to foreign sources for purposes of computing the foreign tax credit limitation, and a ratable part of any expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income (under Code sec. 862(b)). In computing the amount of the foreign loss, the net operating loss deduction (under sec. 172(a)) is not to be taken into account. In addition, foreign expropriation losses (as defined in sec. 172(k)(1)) or unreimbursed casualty or theft losses are not subject to the recapture provision. A taxpayer is treated as sustaining a foreign loss whether or not claiming a foreign tax credit for the year of the loss.

Section 904(f) also contains a provision which provides for the recapture of loss when property which was used in a trade or business, and which was used predominantly outside of the United States, is disposed of prior to the time the loss has been fully recap-

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[3] In 1969, the House of Representatives passed a foreign loss recapture provision that would have applied to taxpayers electing the now-repealed per-country limitation (H.R. 13270, 91st Cong., 1st Sess.; see H.R. Rep. No. 91-143, agreement between the House and the Senate did not include that provision. In the Tax Reduction Act of 1975, the Congress enacted a foreign loss recapture rule that applied only to foreign oil-related income (Public Law 94-12, sec. 601, adding Code sec. 907(f)).

[4] This recharacterization is also referred to as re-sourcing or simply as recapture.

tured. This provision applies regardless of whether gain would otherwise be recognized.

Where gain would otherwise not be recognized, the taxpayer is treated under this provision as having received gain which is recognized in the year the taxpayer disposes of the property. (The gain to be recognized is limited to the amount of the foreign losses not yet recaptured.) In the case of a recapture resulting from the disposition of the property, 100 percent of the gain (to the extent of losses not previously recaptured) is recaptured. In such a case the 50-percent of gain limit is not applied, and the amount (if any) to be recaptured in future years is reduced by the full amount of the gain.

The application of the foreign loss recapture rule of current law is illustrated in Example B (below). The taxpayer in Example B is Taxpayer 1 of Example A. For simplicity, Example B assumes that Taxpayer 1 chooses to have 100 percent of the foreign income recharacterized as domestic income in the year in which recharacterization takes place.

EXAMPLE B (PRESENT LAW)

	Year 1	Year 2	2-year total
Taxpayer 1:			
Foreign-source income (loss)	($100)	$100	0
U.S.-source income	100	100	$200
Worldwide taxable income	0	200	200
Foreign tax (46 percent)	0	46	46
U.S. tax (46 percent)	0	92	92
Allowable foreign tax credit	0	[1] 0	0
Net U.S. tax	0	92	92
Excess foreign tax credit	0	46	46

[1] Foreign tax credit limitation: Foreign source income (zero, since it has been recharacterized as U.S. income)/worldwide taxable income ($200) multiplied by U.S. tax ($92) equals 0.

Under the foreign loss recapture rule, Taxpayer 1 pays $92 of U.S. tax on U.S.-source taxable income of $200 for the 2-year period. A comparison of Examples A and B shows that this is the same amount of U.S. tax paid by Taxpayer 2 in Example A, who also had U.S.-source taxable income of $200 for the two-year period, but no foreign losses.In addition, $92 of U.S. tax is the amount normally due on $200 of U.S.-source taxable income, assuming a 46-percent average U.S. tax rate.

Foreign tax credit carryovers

Under present law, excess foreign tax credits (*i.e.*, foreign taxes which, because of the foreign tax credit limitation, cannot be credited in the year paid or accrued) generally may be carried back for 2 years and carried forward for five years (sec. 904(c)).

The Congress enacted the foreign tax credit carryback and carryover in 1958 to eliminate the double taxation which sometimes resulted under prior law when a method of reporting income in a foreign country differed from the method in the United States. This may result in reporting the same income in one year in the United States and in another year in the foreign country. When this occurs, the foreign tax credit currently available under the foreign tax credit limitation tends to be less than the taxes paid or accrued to the foreign country in the year the income is reported in that country but not in the United States. In another year when this income is reported in the United States but not the foreign country, the credit which will be available currently under the limitation tends to exceed the foreign taxes paid or accrued.[5]

Section 904(c) permits foreign taxes which cannot be claimed currently as a tax credit to be carried back successively to the second and first preceding taxable years and then forward to the first, second, third, fourth, and fifth succeeding taxable years. The credits so carried are deemed paid or accrued in the earlier or later years and may be used in such years to the extent that creditable foreign taxes actually paid or accrued for such years do not equal or exceed the applicable foreign tax credit limitation amounts. Under this rule, current foreign taxes are credited against U.S. tax before foreign taxes carried from other years are credited against U.S. tax.

In contrast with foreign tax credits, investment tax credits generally may be carried forward for 3 years and carried over for 15 years (sec. 46(b)). In addition, investment tax credits are utilized in accordance with a first-in first-out (FIFO) ordering rule. Under this rule, investment credit carryovers are used before current investment credits (sec. 46(a)(1)).

In any taxable year, foreign tax credits (including carrybacks and carryovers) are used before all other types of income tax credits, excluding the credit for the elderly. However, net operating loss carrybacks and carryovers generally reduce income, and hence U.S. tax, before foreign tax and other credits are used.

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[5] The report of the House Committee on Ways and Means on the legislation creating the foreign tax credit carryback and carryover listed factors which may result in a difference in the timing of reporting of income and allowance of deductions: "(1) Reporting of taxable income from sales on the installment basis in the United States without being permitted to report in a similar manner in a foreign country (or possession of the United States); (2) Differences under the laws of the United States and those of the foreign country in the pricing of inventories (this may result in the reporting of income from the ultimate sale of such articles in a different year in the United States than in the foreign country); (3) Differences in reporting foreign exchange profit or loss (such profit or loss may be reported on the accrual basis in the United States but only on the cash basis in some foreign countries); (4) Differences in depreciation methods in the United States and in the foreign country; (5) The requirement of some countries that income taxes be determined only on a fiscal-year basis; and (6) The use of an averaging device in the computation of taxable income in certain foreign countries covering more than one taxable year. *See* H.R. Rep. No. 775, 85th Cong., 1st Sess. 27–28 (1957).

Explanation of the Bill

a. Domestic loss recapture rule

In general

The bill would establish a domestic loss recapture rule the operation of which would be similar to the operation of the present foreign loss recapture rule (Code sec. 904(f)).

The recapture of domestic losses would be accomplished under the bill by treating as income from foreign sources a portion of domestic income which is derived after a year in which an overall domestic loss is incurred. The portion of domestic income treated as income from foreign sources would represent the overall domestic loss which, in the previous year, had the effect of reducing precredit U.S. tax and, consequently, the potentially utilizable amount of foreign tax credits in that year. The effect of the recharacterization would be to increase the foreign tax credit limitation and, thus, potentially, the amount of utilizable foreign tax credits, in the later year or years.

Amount subject to recapture

The amount of domestic income treated as foreign-source income in a subsequent year would be limited under the bill to the lesser of the amount of the overall domestic loss (to the extent that the loss has not been recaptured in prior taxable years) or 50 percent of the domestic taxable income for that year, or such larger percentage as the taxpayer may choose. Thus, in any taxable year the amount subject to recapture would not exceed 50 percent of the taxpayer's domestic income (before recharacterization), unless the taxpayer chose to have a greater percentage of domestic income so recharacterized.

Definition of overall domestic loss

For purposes of the domestic loss recapture rule, the bill would define the term overall domestic loss to mean the amount by which the taxpayer's gross income from sources within the United States (including the amount, if any, that is treated as income from sources within the United States under the foreign loss recapture rule) is exceeded by the sum of the deductions properly apportioned or allocated to domestic sources, to the extent such loss amount offsets income from foreign sources.

In computing the amount of the overall domestic loss, casualty or theft losses would not be taken into account. The definition of overall domestic loss contained in the bill, unlike the present-law definition of overall foreign loss (Code sec. 904(f)(2)), would not expressly provide that the net operating loss deduction (sec. 172(a)) is not to be taken into account in computing the overall loss. Under the bill, a taxpayer would be treated as sustaining a domestic loss whether or not claiming a foreign tax credit for the year of the loss.

Amendments to foreign loss recapture rule

The bill would amend the foreign loss recapture rule in a minor respect. It would modify the definition of overall foreign loss for foreign loss recapture rule purposes so that domestic income re-characterized as foreign income under the domestic loss recapture rule would be counted in the computation of overall foreign loss.

Example

Example C (below) shows how, under present law, two taxpayers with the same total taxable worldwide income and foreign taxes over a two-year period, one of whom has domestic losses in one year and one of whom does not, may pay different amounts of U.S. tax and may use different amounts of foreign tax credits over the two-year period.

EXAMPLE C (PRESENT LAW)

	Year 1	Year 2	2-year total
Taxpayer 3 (overall domestic loss):			
Foreign-source income (loss)	$100	$100	$200
U.S.-source income	(100)	100	0
Worldwide taxable income	0	200	200
Foreign tax (46 percent)	46	46	92
Pre-credit U.S. tax (46 percent)	0	92	92
Allowable foreign tax credit	0	[1] 46	46
Net U.S. tax	0	46	46
Excess foreign tax credit	46	0	46
Taxpayer 4 (no overall domestic loss):			
Foreign-source income (loss)	100	100	200
U.S.-source income	0	0	0
Worldwide taxable income	100	100	100
Foreign tax (46 percent)	46	46	92
Pre-credit U.S. tax (46 percent)	46	46	46
Allowable foreign tax credit	46	[2] 46	92
Net U.S. tax	0	0	0
Excess foreign tax credit	0	0	0

[1] Foreign tax credit limitation: Foreign source income ($100)/worldwide taxable income ($200) multiplied by U.S. tax ($92) equals $46.

[2] Foreign tax credit limitation: Foreign source income ($100)/worldwide taxable income ($100) multiplied by U.S. tax ($46) equals $46.

In Example C, each taxpayer has a total two-year worldwide taxable income of $200. Each has no U.S.-source taxable income for the two-year period. The taxpayer with an overall domestic loss (Taxpayer 3) pays $46 in U.S. tax and $92 in foreign tax for the two-year period and accrues $46 of excess foreign tax credits. Taxpayer 4, the taxpayer with no domestic loss, pays no U.S. tax and

$92 in foreign tax for the two-year period and accrues no excess foreign tax credits.

Enactment of the domestic loss recapture rule would have the effect on Taxpayer 3 illustrated in Example D below. Example D assumes that Taxpayer 3 chooses to have 100 percent of U.S.-source income recharacterized as foreign income in Year 2.

EXAMPLE D (UNDER S. 1584)

	Year 1	Year 2	2-year total
Taxpayer 3:			
Foreign-source income (loss)	$100	$100	$200
U.S.-source income	(100)	100	0
Worldwide taxable income	0	200	200
Foreign tax (46 percent)	46	46	92
U.S. tax (46 percent)	0	92	92
Allowable foreign tax credit	0	[1] 92	92
Net U.S. tax	0	0	02
Excess foreign tax credit	46	(46)	0

[1] Foreign tax credit limitation: Foreign source income ($200, since the domestic income in Year 2 is recharacterized as foreign income)/worldwide taxable income ($200) multiplied by $92 equals $92.

Under the domestic loss recapture rule, Taxpayer 3 would pay no U.S. tax and accrue no excess foreign tax credits for the two-year period. A comparison of Examples C and D shows that this is the same U.S. tax and excess foreign tax credit position as that of a taxpayer who does not have domestic losses (Taxpayer 4).

Effective date

The domestic loss recapture rule and related amendments would apply to taxable years beginning after 1981.

b. Extended carryover period for certain excess foreign tax credits

The bill would increase the foreign tax credit carryover period from five years to 15 years for excess foreign tax credits that arise in taxable years beginning after 1978.

c. FIFO ordering rule for foreign tax credits

In general

The bill would provide a new first-in first-out (FIFO) ordering rule for utilization of foreign tax credits. Under this rule, foreign tax credits that arise currently in the taxable year would no longer be the first foreign tax credits utilized in the taxable year; instead, foreign tax credits would generally be utilized in the order in which they arose. Thus, in any taxable year, foreign tax credit carryovers would be utilized first.

If such carryovers did not equal or exceed the foreign tax credit limitation for the year, then foreign tax credits arising currently would be utilized. If the sum of the foreign tax credit carryovers and current credits did not equal or exceed the foreign tax credit limitation for the year, then foreign tax credit carrybacks would be utilized.

The bill would also clarify the present computational rules for foreign tax credit carrybacks and carryovers.

Effective date

The FIFO ordering rule and related amendments would be effective with respect to taxable years beginning after 1981.

ISSUES

Excess foreign tax credits

Excess foreign tax credits result when the amount of foreign creditable income taxes paid or accrued in a given year exceeds the taxpayer's foreign tax credit limitation. Excess credits are, therefore, the result of the limitation and can arise for a variety of reasons, all of which involve the limitation. Timing differences in the reporting of income and deductions under U.S. and foreign tax laws may result in a taxpayer's being unable to utilize some foreign tax credits in a year in which income is reported in a foreign country but not in the United States. Differences between the sourcing rules or the deduction allocation rules of the United States (whose rules are consistent with international norms generally recognized by developed countries) and those of other countries may result in U.S. treatment of income taxed by another country as domestic income for purposes of the foreign tax credit.[6] Also, effective corporate income tax rates in many countries are higher than U.S. income tax rates.

Today, a significant reason for excess credits of some companies is domestic losses. Domestic losses may reduce worldwide taxable income and pre-credit U.S. tax and, hence, the amount of foreign tax credits that can be used currently.

Proponents of S. 1584 argue that excess credits represent an additional cost of conducting business abroad that can place U.S. companies at a competitive disadvantage vis a vis foreign companies. The bill, they argue, by reducing excess credits, would prvent double taxation, reduce this additional cost, and improve the competitive position of U.S. companies.

Tax planning

The focus of international tax planning by U.S. taxpayers is the maximization of foreign tax credit utilization. By increasing foreign tax credit utilization, a taxpayer can reduce its worldwide tax burden. Under present law, taxpayers have a number of planning opportunities. For example, taxpayers can increase credit utiliza-

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[6] For example, many developing countries impose gross withholding taxes on payments for technical services that a U.S. taxpayer performs in the United States for use within their borders. The United States treats the payments as U.S. domestic source income for purposes of computing the foreign tax credit limitation, with the result that the foreign taxes may not be creditable in the year paid.

tion through their control of the timing of dividend payments by foreign subsidiaries and the timing of deemed distributions under the controlled foreign corporation rules (Code secs. 951-64, often referred to as Subpart F).

Those favoring the bill argue that by reducing excess foreign tax credits, the bill would reduce current planning pressures. Others argue, however, that the bill might provide expanded planning opportunities that would allow some taxpayers to reduce U.S. tax in unintended ways.

Annual accounting period

Some taxpayers with equal worldwide incomes and effective foreign tax rates over a period of years pay different total amounts of U.S. tax because of differences in the distribution of income and loss over the period. It is the required use of the annual accounting period that causes these differences in income distribution over time to produce differences in U.S. tax liabilities among similarly situated taxpayers.

Proponents of the bill point out that the Code contains numerous provisions to mitigate these differences in tax liabilities, such as the foreign tax credit carryover and carryback. The use of the annual accounting period, they note, is arbitrary; it is used primarily for administrative convenience. They argue further that taxpayers who are able to control the timing of income and loss can avoid the harsh effects of the annual accounting period and, therefore, such taxpayers enjoy an unfair advantage over taxpayers who are unable to control the timing of income and loss.

Proponents of S. 1584 argue that the bill would reduce differences (attributable to the use of the annual accounting period) in the U.S. tax liabilities of taxpayers with the same worldwide incomes and effective foreign tax rates over a period of years. For example, as Examples C and D (above) indicate, the domestic loss recapture rule would equalize the U.S. tax burdens of two taxpayers with equal worldwide incomes and foreign taxes over a two-year period, one of whom has a domestic loss during the period, and one of whom does not. Similarly, the extension of the carryover period for foreign tax credits would prevent the expiration of foreign tax credits and would, therefore, reduce U.S. tax differences between taxpayers with the same total foreign taxes over a period of years, some of whom can credit their foreign taxes currently, and some of whom cannot.

Reduction of foreign income by domestic losses

As indicated above, under the present U.S. system of computing worldwide taxable income, domestic losses initially offset same-year foreign income. Only those losses in excess of same-year foreign income may be carried back or forward. Because domestic losses reduce worldwide income and hence pre-credit U.S. tax, the losses may cause foreign tax credits (and other income tax credits) to expire unused. Proponents of the legislation argue that the bill would significantly ease the credit expiration problem.

In addition, those favoring the bill argue that taxpayers who have domestic losses and pay foreign taxes in the same taxable year may lose the full benefit of accelerated cost recovery system

(ACRS) deductions and other investment incentives. ACRS deductions contribute to domestic tax losses, which offset same-year foreign income. A taxpayer with high-taxed foreign income pays no U.S. tax on that income, because of the foreign tax credit. If this taxpayer also has a U.S. tax loss including ACRS deductions, those ACRS deductions do not reduce current U.S. tax, and they are not available for carryover. Proponents of the bill argue that if ACRS deductions are lost, taxpayers are not receiving the tax benefit that Congress intended in enacting ACRS. Domestic loss recapture, they argue, would in effect return the benefits of ACRS to the taxpayers in later years.

Some have suggested that the real problem is that U.S. losses offset foreign income, and foreign losses offset U.S. income. They have suggested an alternative system for computing worldwide taxable income, sometimes called a "separate basket" system, be substituted for the present system. Under a separate basket system, the aggregation of same-year domestic and foreign income (and loss) would be eliminated, and domestic losses would be carried back or forward in their entirety. Domestic losses in a taxable year would no longer displace foreign tax credits that would otherwise have been utilized in that year. The carryback and carryover of domestic losses in their entirety would preserve ACRS deductions. A separate basket system would eliminate the need for the foreign loss recapture rule as well as the need for the domestic loss recapture rule.

Domestic loss recapture rule

Consistency in tax treatment of foreign and domestic losses.—Proponents of the domestic loss recapture rule argue, on the other hand, that the Congress overlooked the domestic loss issue when it considered and enacted the foreign loss recapture rule in 1976. The substantial domestic losses incurred by some companies in recent years, proponents suggest, have pushed the issue into prominence and increased the need for domestic loss recapture. The amendments required to implement the domestic loss recapture rule, they argue further, are technical rather than substantive in nature.[7]

In the view of proponents, consistency in the tax treatment of foreign and domestic losses requires the adoption of the rule. They argue that, just as the foreign loss recapture rule eliminated disparities in the tax treatment of taxpayers who differed only in that some had overall foreign losses over a period of years and some did not, the domestic loss recapture rule would eliminate disparities in the tax treatment of taxpayers who differ only in that some have overall domestic losses over a period of years and some do not. In their view, the domestic loss recapture rule is needed to establish symmetry in the rules governing losses.

On the other hand, it can be argued that the foreign loss recapture rule arose in response to certain specific problems in the operation of the foreign tax credit system with which domestic losses are unconnected. The foreign loss recapture rule was enacted be-

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[7] Proponents of the domestic loss recapture rule also assert that the failure to enact the rule in 1976, when the Congress enacted the foreign loss recapture rule, amounted to a partial repeal of the foreign tax credit.

cause overall foreign losses reduced U.S. tax while U.S. tax on foreign income in later years was reduced or eliminated by foreign income taxes imposed on that income. Often, the losses were start-up losses from new foreign investment by the U.S. taxpayer, and the foreign income tax in the second year resulted because the foreign country did not allow a carryover of the prior years' losses. The result was that the U.S. Treasury bore the cost of the foreign investment while the foreign country got the tax on the income from the investment. Thus, it could be argued that the foreign loss recapture rule protects the revenue by preventing taxpayers from gaining a double benefit at the expense of the Treasury.

In any event, it can be argued, the domestic loss recapture rule, as presently drafted in S. 1584, would not establish consistency in the tax treaty of foreign and domestic losses. Losses of foreign susidiaries are not recaptured under the foreign loss recapture rule; only losses of foreign branches or losses on the sale of stock or other assets are.[8] Under S. 1584, by contrast, domestic losses are recaptured to the extent they offset either foreign branch or foreign susidiary income. Also, as discussed in more detail below, S. 1584 does not have a provision like the foreign loss recapture rule provision requiring recapture upon the disposition of certain property.

Incentive to reduce foreign taxes.—Because the United States provides a foreign tax credit, incentives to reduce foreign taxes may increase U.S. tax revenues. As noted previously, the overall limitation prevents a taxpayer in any taxable year from crediting foreign taxes in excess of total pre-credit U.S. tax on foreign-source income for the taxable year. The overall limitation thus gives taxpayers an incentive to keep their total foreign taxes at a level no higher than their total pre-credit U.S. taxes on foreign income.[9] The domestic loss recapture rule might reduce this foreign tax reduction incentive somewhat; the re-resourcing of certain domestic income as foreign income for purposes of the foreign tax credit limitation would permit some taxpayers in some years to credit foreign taxes in excess of pre-credit U.S. tax on foreign income.

However, as proponents of the bill have pointed out, use by the United States of a foreign tax credit (rather than a foreign income exemption) system already removes much of a taxpayer's incentive to reduce foreign taxes and, consequently, the impact of the domestic loss recapture rule on the incentive would be relatively slight.

Transfer of domestic loss recapture benefits.—The existence of recoverable losses of a company might be regarded as a financial asset by would-be acquiring corporations. Various provisions of present law restrict the transfer of other tax attributes, such as net operating losses and excess foreign tax credits, between acquired and acquiring corporations. The bill does not contain any restriction on the use by an acquiring corporation of an acquired company's domestic loss recapture benefits. Such a restriction may be necessary to prevent trafficking in domestic loss recapture benefits.

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[8] Losses of foreign subsidiaries are not recaptured because such losses are not included in the computation of worldwide income for U.S. tax purposes.

[9] This incentive operates over time rather than discretely in each year because of the foreign tax credit carryover and carryback.

Proponents of the bill argue that, while a company with a recapturable domestic loss might be more attractive to a would-be acquiring corporation than a company with a domestic loss not subject to recapture, as between a company without losses and a company with a recapturable domestic loss, the comparative attraction of the loss company would not be greatly enhanced by the domestic loss recapture rule.

If a restriction on the use by an acquiring corporation of an acquired company's domestic loss recapture benefits is deemed necessary, some proponents suggest that it might be modelled after the limitation on transfer of the consolidated foreign tax credit carryover and carryback contained in the Treasury regulations governing consolidated returns (Treas. Reg. sec. 1.1502).

Recapture of loss upon disposition of property.—The foreign loss recapture rule contains a provision that requires the recapture of loss when property which was used in a trade or business, and which was used predominantly outside the United States is disposed of prior to the time a loss has been fully recaptured (Code sec. 904(f)(3)). This provision applies regardless of whether gain on the disposition of the property would otherwise be recognized. The bill does not contain a parallel provision for domestic loss recapture applicable to dispositions of property used predominantly within the United States.

Proponents of the bill argue that such a parallel provision would be inappropriate. Section 904(f)(3) is necessary, in their view, to prevent taxpayers from avoiding foreign loss recapture by avoiding recognition of foreign gains. There is, on the other hand, they argue, no apparent policy reason for requiring the recognition of gain otherwise accorded nonrecognition treatment on the disposition of domestic-use property. Nor is there any apparent policy reason, they suggest, for the creation of foreign-source income which the taxpayer would not otherwise have upon the disposition of domestic-use property.

Tax benefit rule.—There is no requirement in the bill that creditable foreign taxes be paid on foreign income offset by domestic losses for recapture of such losses to occur. In the absence of such a requirement, the domestic loss recapture rule may be inconsistent with tax benefit principles. The reason is that, without such a requirement, domestic loss recapture could (as previously noted) take place with respect to domestic losses that do not generate excess foreign tax credits. Since an important purpose of domestic loss recapture is to facilitate the use of excess credits resulting from domestic losses, no recapture arguably should be allowed with respect to losses that generate no excess credits.

Proponents of the bill argue that even if no creditable foreign taxes are paid in a domestic loss year, the domestic loss normally restricts foreign tax credit utilization since taxpayers often have excess credits from other years that could be carried to the domestic loss year, but for the domestic loss. Therefore, permitting recapture of domestic losses even in years when no foreign tax credit arises currently, they argue, does not conflict with tax benefit principles.

Extended carryover period for excess credits

Those who favor the extension of the foreign tax credit carryover period from five to 15 years argue that the extension would conform the foreign tax credit carryover period with the current 15-year carryover period for net operating losses and investment tax credits (and the 15-year carryover period for the targeted jobs credit, the alcohol fuels credit, and the research credit).

The proponents of the provision point out that the carryover and carryback periods for net operating losses and investment tax credits have been liberalized several times over the last few decades, while the carryback and carryover periods for the foreign tax credit have not been changed since the carryback and carryover were first enacted in 1958. They note the recognition by the Congress that net operating losses (by reducing pre-credit U.S. tax) may cause both investment tax credits and foreign tax credits to expire unused; they argue that the enactment of the accelerated cost recovery system (ACRS) in 1981 potentially increased the magnitude of the problem, since ACRS deductions may increase net operating losses. The Congress, they argue, tried to forestall this unintended result of ACRS in the case of the investment tax credit, by extending the investment tax credit carryover period to its present 15 years at the time ACRS was enacted.

Proponents further argue that the appropriate length for any carryover period (whether for net operating losses, investment tax credits, or foreign tax credits) cannot be determined with absolute precision. Therefore, in their view, a carryover period should be sufficiently lengthy to minimize the likelihood that the purpose of the tax attribute at issue (i.e., net operating losses, investment tax credits, or foreign tax credits) will be frustrated by the expiration of that tax attribute.

On the other hand, the present two-year carryback, five-year carryover, it can be argued, preserves the "matching" rule inherent in the foreign tax credit system: to prevent double taxation, a foreign tax credit is allowed for foreign taxes paid on certain income in order to offset pre-credit U.S. tax on *that* income. As discussed earlier, the Congress enacted the foreign tax credit carryback and carryover because differences in the rules for reporting income in the United States and other countries sometimes resulted in reporting the same income in one year in the United States and in another year in a foreign country. When income was reported in the United States in an earlier year than in a foreign country, the foreign taxes paid or accrued in the earlier year, and therefore the applicable foreign tax credit, tended to fall short of the foreign tax credit limitation. Thus, the foreign taxes did not fully offset U.S. tax on that income in the earlier year. Later, when the income was reported in the foreign country, the foreign taxes paid or accrued in the later year, and therefore the applicable foreign tax credit, tended to exceed the foreign tax credit limitation. These foreign taxes could not be used to offset the earlier-imposed U.S. tax on the income.

The present two-year carryback and five-year carryover arguably prevent the mismatching of income and credits and consequent double taxation that resulted from such timing differences in the reporting of income under U.S. law and foreign law.

A longer carryover (or carryback), on the other hand, might permit the foreign taxes paid on one year's income to offset pre-credit U.S. tax on another year's income (after timing differences in reporting income are accounted for), and thus contravert the matching principle. If the length of the present carryover period already, on occasion, gives rise to such mismatching, then extending the carryover period would, of course, enlarge the problem.

A longer carryover period may be appropriate for the investment tax credit and net operating loss because the purposes of the carryover for these tax attributes differ significantly from the purpose of the carryover for the foreign tax credit. That is, the matching principle just described has no apparent relevance to the investment tax credit or net operating loss.

The purpose of the investment tax credit carryover is to preserve the investment incentive that the investment tax credit was enacted to provide. The net operating loss carryover functions as a general averaging device to alleviate the harsh effects often resulting from the use of the one-year accounting period. The net operating loss carryover also shields businesses during difficult economic times and reduces differences in the total tax liabilities, over a multi-year period, of taxpayers with equal incomes over the period, some of whom have net operating losses and some of whom do not during the period.

FIFO ordering rule

Proponents of the adoption of a first-in first-out (FIFO) ordering rule for utilization of foreign tax credits argue that the adoption of a FIFO rule would conform the foreign tax credit ordering rules with the investment tax credit ordering rules.

A FIFO rule for foreign tax credit utilization, however, would be inconsistent with the matching principle inherent in the foreign tax credit system. Under a FIFO rule, foreign taxes paid in earlier years would be credited against pre-credit U.S. tax on later-year income before the foreign taxes actually paid on the later-year income would be credited. Thus, the matching of current foreign tax credits with the pre-credit U.S. tax on the current income that gave rise to the credits would be eliminated to the extent that credit carryovers equaled or exceeded the pre-credit U.S. tax.

As previously noted, the matching principle has no apparent relevance to the investment tax credit. In addition, the Congress adopted a FIFO ordering rule for the investment tax credit because it was concerned that the desire of taxpayers to use credit carryovers as quickly as possible could significantly dampen the stimulative effect of the credit on new investments. Taxpayers, the Congress concluded, might have made fewer new investments if required use of the credits for new investments before older carryover credits caused the taxpayers to lose the carryover credits.

Proponents of the adoption of a FIFO ordering rule (and the extension of the carryover period) for foreign tax credits argue, on the other hand, that the matching of current foreign tax credits for foreign taxes paid on current income with the pre-credit U.S. tax otherwise due on that income is already imprecise under present law because of the mandatory use of the overall limitation. Under the overall limitation, foreign taxes paid in a particular foreign country are not matched, for crediting purposes, with the pre-credit U.S. tax due on the income earned in that foreign country, as they would be under a per-country limitation.

4. S. 1814—Senator Packwood

Deduction for Loss in Value of Bus Operating Authorities

Background

Prior to enactment of the Bus Regulatory Reform Act of 1982, intercity bus operators were required to obtain a bus operating authority before providing service on a particular route. Only a limited number of bus-operating authorities were issued. Persons wishing to enter a route often purchased an existing business that already owned an operating authority, and substantial amounts were paid for these operating authorities. Thus, the value of bus operating rights constituted a substantial part of a bus operator's assets and a source of loan collateral.

The 1982 statute, in deregulating intercity buses, allows intercity bus operators to enter on, expand, drop, or change routes, free of Federal barriers. As a result of the relative ease of entry into the intercity bus business, the value of bus operating authorities has diminished significantly.

The owners of bus operating authorities state that their situation is similar to that faced by owners of motor carrier operating authorities after enactment of the Motor Carrier Act of 1980. That statute deregulated the trucking industry; as a result, motor carrier operating authorities lost significant value. In the Economic Recovery Tax Act of 1981, the Congress enacted a provision allowing trucking companies an ordinary deduction ratably over five years for loss in value of motor carrier operating authorities (sec. 266 of the 1981 Act).

Present Law

A deduction is allowed for any loss incurred in a trade or business during the taxable year, if the loss is not compensated for by insurance or otherwise (Code sec. 165(a)). In general, the amount of the deduction equals the adjusted basis of the property giving rise to the loss (sec. 165(b)). Treasury regulations provide that, to be deductible, a loss must be evidenced by a closed and completed transaction (i.e., must be "realized"), and must be fixed by an identifiable event (Treas. Reg. sec. 1.165-1(b)).

As a general rule, no deduction is allowed for a decline in value of property absent a sale, abandonment, or other disposition. Thus, for a loss to be allowed as a deduction, generally the business must be discontinued or the property must be abandoned (Treas. Reg. sec. 1.165-2)). Further, if the property is a capital asset and is sold or exchanged at a loss, the deduction of the resulting capital loss is subject to limitations (secs. 1212, 1211, and 165(f)).

The courts have denied a loss deduction where the value of an operating permit or license decreased as the result of legislation expanding the number of licenses or permits that could be issued. In the view of several courts,[1] the diminution in the value of a license or permit does not constitute an event giving rise to a deductible loss if the license or permit continues to have value as a right to carry on a business.

Explanation of the Bill

The bill would allow an ordinary deduction ratably over a 60-month period for taxpayers who held one or more bus operating authorities on November 19, 1982 (the date of enactment of the Bus Regulatory Reform Act of 1982). The amount of the deduction would be the aggregate adjusted bases of all bus operating authorities that were held by the taxpayer on November 19, 1982, or acquired after that date under a contract that was binding on that date.

The 60-month period would begin with the later of November 1, 1982, or, at the taxpayer's election, the first month of the taxpayer's first taxable year beginning after that date. The bill would require that adjustments be made to the bases of authorities to reflect amounts allowable as deductions under the bill.

Under regulations to be prescribed by the Treasury, a taxpayer (whether corporate or noncorporate) holding an eligible bus operating authority would be able to elect to allocate to the authority a portion of the cost to the taxpayer of stock in an acquired corporation. The election would be available if the bus operating authority was held (directly or indirectly) by the taxpayer at the time its stock was acquired. In such a case, a portion of the stock basis would be allocated to the authority only if the corporate or noncorporate taxpayer would have been able to make such an allocation had the authority been distributed in a liquidation to which prior-law section 334(b)(2) applied. The election would be available only if the stock was acquired on or before November 19, 1982 (or pursuant to a binding contract in effect on such date).

Effective Date

The provision would be effective retroactively for taxable years ending after November 18, 1982.

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[1] *See, e.g., Consolidated Freight Lines, Inc.* v. *Comm'r,* 37 B.T.A. 576 (1938), *aff'd,* 101 F.2d 813 (9th Cir.), *cert. denied,* 308 U.S. 562 (1939) (denial of loss deduction attributable to loss of monopoly due to State deregulation of the intrastate motor carrier industry); *Monroe W. Beatty,* 46 T.C. 835 (1966) (no deduction allowed for diminution in value of liquor license resulting from change in State law limiting grant of such licenses).

5. S. 1815—Senator Packwood

Exemption for Certain Title-Holding Corporations

Present Law

Under present law, a corporation that is organized for the exclusive purpose of holding title to property, collecting income therefrom, and distributing the income (less expenses) to a tax-exempt organization is itself exempt from Federal income tax (Code sec. 501(c)(2)). The Internal Revenue Service has taken the position, in General Counsel Memorandum,[1] that this provision means that the title-holding corporation may distribute income only to one or more related tax-exempt organizations.

Most organizations that are exempt from Federal income taxation generally are subject to tax on any unrelated trade or business taxable income (secs. 511-513). The term unrelated trade or business generally means any trade or business the conduct of which is not substantially related to the exercise or performance by the tax-exempt organization of the activities for which the organization was granted tax exemption. In general, the rental of real property by a tax-exempt organization does not give rise to unrelated business taxable income (sec. 512(b)(3)).

Present law also provides that income of an exempt organization from debt-financed property (unless the use of the property itself is substantially related to the organization's exempt function) is subject to the unrelated business income tax in the proportion in which the property is financed by the debt (sec. 514). Debt-financed property means all property (including rental real estate, tangible personal property, and corporate stock) that is held to produce income and with respect to which indebtedness was incurred to acquire or improve the property or would not have been incurred but for the acquisition or improvement of the property.

However, a special rule applies under present law to real property acquired by a tax-exempt trust forming part of a tax-qualified pension, profit-sharing, or stock bonus plan (sec. 514(c)(9)). Under this rule, debt-financed real property acquired by the exempt trust is not treated as debt-financed property unless one of five exceptions to the rule applies.

Explanation of the Bill

The bill would exempt from Federal income tax any corporation organized exclusively to acquire, hold title to, and collect income from property and turn over all income (less expenses) from the property to one or more qualifying organizations, whether or not related. For this purpose, qualifying organizations would be defined

[1] *E.g.*, G.C.M. 37351, December 20, 1977.

as (1) a qualified pension, etc., plan (Code sec. 401(a)); (2) a governmental plan (sec. 414(d)); (3) the United States, any State or political subdivision, or any agency or instrumentality of such a governmental unit; or (4) a charitable organization (sec. 501(c)(3)).

In addition, for purposes of the special rule under present law relating to debt-financed property, the bill would treat the title-holding corporation the same as an exempt trust forming part of a qualified pension, etc., plan.

Effective Date

The bill would be effective for taxable years beginning after December 31, 1983.

6. S. 1826—Senator Danforth

"Hunger Relief Incentives Tax Act of 1983"

Present Law

General rule

In general, the amount of charitable deduction otherwise allowable for donated property must be reduced by the amount of any ordinary gain which the taxpayer would have realized had the property been sold for its fair market value on the date of the donation (Code sec. 170(e)). Thus, a donor of inventory or other ordinary-income property (property the sale of which would not give rise to long-term capital gain) generally may deduct only the donor's basis in the property, rather than its full fair market value. In the case of property used in the taxpayer's trade or business, the charitable deduction must be reduced by the amount of depreciation recapture which would be recognized on the sale of the donated property.

Under present law, no deduction is allowed for the value of services donated to a charitable organization. However, a taxpayer may deduct unreimbursed out-of-pocket expenses (such as fuel costs) incurred incident to the rendition of such services (Treas. Reg. sec. 1.170A-1(g)).

Special contributions rule

Under a special rule enacted in 1976, corporations (other than subchapter S corporations) are allowed an augmented charitable deduction for contributions of certain types of ordinary income property donated for the care of the needy, the ill, or infants (sec. 170(e)(3)).[1]

To qualify for this augmented charitable deduction, a contribution of ordinary income property must satisfy the following requirements:

(1) The donee must be a public charity (other than a governmental unit) or a private operating foundation;

(2) The donee must use the property in a use related to the donee's tax-exempt purpose and solely for the care of the ill, the needy, or infants;

(3) The property must be inventory property (within the meaning of sec. 1221(1)) or property used in the donor's trade or business (within the meaning of sec. 1221(2));

(4) The donee must not transfer the property in exchange for money, other property, or services; however, Treasury regulations

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[1] Under a special rule enacted in 1981, an augmented charitable deduction also is allowed for corporate contributions of newly manufactured scientific equipment or apparatus to a college or university for research use in the physical or biological sciences (sec. 170(e)(4)).

permit the donee to charge a fee to another organization in connection with its transfer of the donated property, if the fee is small or nominal in relation to the value of the transferred property, is not determined by the value of the property, and is designed to reimburse the donee for its administrative, warehousing, or other similar costs;[2]

(5) The donor must receive a statement from the donee representing that the donee's use and disposition of the property will comply with requirements (2) and (4) above; and

(6) The property must satisfy the relevant requirements of the Federal Food, Drug, and Cosmetic Act in effect on the date of transfer and for 180 days prior to such transfer.

If all these requirements are satisfied, the augmented charitable deduction allowed for the contribution generally equals the sum of (1) the donor's basis in the donated property and (2) one-half of the unrealized appreciation. However, in no event is a deduction allowed for an amount which exceeds twice the basis of the property. Also, no deduction is allowed for any part of the unrealized appreciation which would have been ordinary income (if the property had been sold) because of the application of the recapture provisions relating to depreciation, mining exploration expenditures, excess farm losses, soil and water conservation expenditures, and land-clearing expenditures.

Explanation of the Bill

The bill would expand in several respects the special augmented charitable deduction rule for property donated for the care of the needy, the ill, or infants.

Eligible donees

The bill would expand the category of eligible donees to include governmental units (as defined in Code sec. 170(c)(1)).[3] Generally, the bill would not otherwise affect donee eligibility under present law.[4]

Contributions of food

The bill would provide that, in the case of a charitable contribution of food that otherwise qualifies for the augmented charitable deduction, the contribution will not be disqualified solely because the donor is not a corporation, if the donor is actively engaged in the trade or business of production or wholesale or retail marketing of food.[5]

In addition, the bill would provide that contributions of food which a donee has removed from the donor's fields ("gleaning") would be treated as qualified contributions. Under the bill, a contribution of food could qualify for the augmented deduction in spite

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[2] Treas. Reg. sec. 1.170A-4A(b)(3)(ii).

[3] In accordance with this change, the use requirement for donated property would be amended to allow use related to the donee's governmental purpose or function.

[4] Under the bill, donee eligibility other than in the case of governmental units would be defined by reference to Code secs. 170(c)(2) and 501(a) rather than, as under present law, by reference to Code secs. 501(c)(3) and 501(a).

[5] Food, for these purposes, would be defined as any agricultural product which is intended for, and at the date of contribution is suitable for, human consumption, and which is not subject to the Federal excise taxes on alcohol or tobacco.

of the donee's charging a fee to the ill or needy individuals or infants who receive the property, if the fee is small or nominal in relation to the value of the transferred property and is not determined by the property's value, and the fee is designed to reimburse the donee for its administrative, warehousing, or similar costs.

Contributions of transportation services

The bill would expand the category of qualified contributions to include certain charitable contributions by a taxpayer of transportation services for the movement of food. Such contributions would qualify if the food itself is a qualified contribution, the taxpayer receives from the donee of the food a written statement representing that the property being moved is a qualified contribution, and the taxpayer is either actively engaged in the trade or business of providing transportation services or is the donor of the property.

Amount of deduction

In the case of a qualified contribution by a taxpayer of transportation services, the bill would provide that the amount of the deduction is the fair market value of services contributed, but not to exceed the lesser of (1) twice the taxpayer's incremental direct costs incurred in providing the services or (2) such direct costs plus one-half of any gain the taxpayer would have realized if the services had been provided by the taxpayer at their fair market value.

In the case of a qualified contribution of food by a donor which is not required to and does not use inventories to compute taxable income (e.g., farmers on the cash basis of accounting for tax purposes), the bill would provide that the amount of the deduction is 50 percent of the gross receipts the donor would have realized if the food had been sold in the ordinary course of the donor's business.[6] This rule would apply both to noncorporate donors of food (to whom the bill extends eligibility for the augmented charitable deduction) and corporate donors of food (who are eligible donees under present law).

In the case of all other qualified contributions, the amount of the augmented charitable deduction would be computed as under present law.

Effective Date

The amendments made by the bill would be effective for qualified contributions made after the date of enactment.

[6] Absent this rule, donors making qualified contributions of food who are not required to use inventories to compute taxable income could be disadvantaged under the general deduction computation rule of Code sec. 170(e)(3), under which the amount of the deduction generally equals the sum of (1) the donor's basis in the donated property and (2) one-half of the unrealized appreciation, because such donors generally would have no basis in the contributed food.

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