

[COMMITTEE PRINT]

DECISIONS ON THE TAX REFORM BILL  
OF 1975 CORRESPONDING TO SECTIONS  
OF DRAFT BILL

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PREPARED FOR THE USE OF THE  
COMMITTEE ON WAYS AND MEANS

BY THE STAFF OF THE  
JOINT COMMITTEE IN INTERNAL REVENUE TAXATION



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## TITLE I—LIMITATION ON ARTIFICIAL LOSSES

### Sec. 101. Limitation on artificial losses.

#### *A. Real Estate*

The committee decided to impose a limitation, commonly referred to as LAL (limitation on artificial losses), on the extent to which losses arising from accelerated deductions on real property can be used to offset income from other real property or on other income generally. Under this decision, the accelerated deductions attributable to real property will be deferred to a later year to the extent that they exceed the taxpayers' net related income from that property. Net related income is gross income from the property less the "ordinary deductions" attributable to that property (deductions other than the accelerated deductions). The limitation is not to apply to true economic losses which will continue to be deductible currently.

The accelerated real estate deductions to be limited as indicated above are the deductions for interest and taxes during the construction period, and accelerated depreciation in excess of straight-line depreciation.

Under the committee's decision, each property will generally be treated separately in applying LAL. As a result, losses attributable to accelerated deductions from one property could not be used to offset income from another property. However, the committee decided to permit the combination of residential properties to a limited extent for this purpose. If an individual taxpayer has an interest in not more than 36 residential dwelling units at any time in a year, he may combine them and treat the income and losses from these properties for that year as if derived from one property. If the taxpayer has an interest in more than 36 residential dwelling units at any one time during a year, this consolidation treatment will not be available.

The rule set out above is to apply only to commercial and residential buildings where the construction begins after December 31, 1975. With respect to commercial property constructed after this date, LAL will apply both to interest and taxes during the construction period and to accelerated depreciation. For residential properties constructed after December 31, 1975, interest and taxes during the construction period will be phased in over a 2-year period: one-half will be subject to LAL in 1977 and all in 1978. Accelerated depreciation on these properties will be subject to LAL starting in 1976.

In the case of certain Federal or State subsidized low-income housing LAL is to apply only where the construction begins in 1978 or later years. In addition, only one-third of the interest, taxes and accelerated depreciation are to be subject to LAL in 1978, and two-thirds in 1979. In 1980, LAL is to apply to all construction period interest and taxes and accelerated depreciation.

#### *B. Farm Operations*

The committee decided to impose LAL on the extent to which losses arising from accelerated deductions from farm operations can be used

to offset nonfarm income. Under this decision, the accelerated deductions attributable to farm operations will be deferred to a later year to the extent that they exceed the taxpayers' net related income from farm operations. (Net related income is gross income from farm operations less the "ordinary deductions" attributable to farm operations—deductions other than the accelerated deductions.) The limitation is not to apply to economic losses which will continue to be deductible currently.

The accelerated farm deductions, which are limited as indicated above, generally include: (1) prepaid feed, seed, fertilizer and similar farm supply expenses; (2) preproductive period expenses of raising livestock (including horses) and growing an agricultural crop (including crops where the preproductive period begins in one year and ends in another even though the total period is less than one year); and (3) accelerated depreciation of livestock after they have begun to be productive in the taxpayer's business.

Under the committee's decision, a taxpayer generally can aggregate the results of all farm operations in applying LAL. However, LAL is to apply separately for each farm interest in the case of each syndicated or similar offering. Where a farmer processes his farm products, the committee decided to include income from processing as farm income.

Under the committee decision, losses attributable to accelerated deductions in farm operations may be used to offset \$20,000 of nonfarm income, but if a taxpayer has nonfarm income over \$20,000, the amount of artificial farm loss allowable as a current deduction from nonfarm income would be reduced from \$20,000, on a dollar-for-dollar basis, for each dollar of nonfarm income in excess of \$20,000. This means that no artificial farm losses could be taken as deductions currently by taxpayers who have nonfarm income of \$40,000 or more.

The committee decision would apply LAL to individuals, estates and trusts, and corporations which are excepted from the provision requiring certain farm corporations to use the accrual method of accounting for their farm operations. In addition, LAL would not apply to any taxpayers who use the accrual method of accounting and who capitalize their preproductive expenses.

LAL is to apply to accelerated deductions paid or incurred after 1975, including prepaid supplies purchased, preproductive expenses paid or incurred and accelerated depreciation incurred after that time with respect to existing farm operations.

#### *C. Oil and Gas*

Under the Committee decision, LAL would apply to intangible drilling and development costs on developmental oil and gas wells on a property-by-property basis. As a result, these deductions could not be taken in any year to the extent they exceed the net "related" income derived in that year from the operation of the same property. The amount of the related income (against which the intangible drilling costs could be deducted) would be reduced by the amount of any percentage depletion and dry hole deduction taken with respect to that income. Any excess deductions would be placed in a "deferred deduction account" until such time as the taxpayer has income from that property. If not previously deducted, expenses attributable to a dry hole would be deductible in full in the year in which the dry hole was completed.

Under the Committee decision, in order not to discourage continued exploration for new oil and gas resources, LAL would not apply to intangible drilling and development costs incurred in connection with exploratory wells. An exploratory well, for these purposes, includes any well which is located at least two miles from a producing well, and any well which is within the two-mile limit if a measurement of the bottom hole pressure indicates that the well taps a new, deeper reservoir. In addition, a well could be treated as an exploratory well if the taxpayer can establish to the satisfaction of the IRS that, under all the facts and circumstances, the well in question has tapped a new reservoir from which there has been no production in the past.

These rules would apply to costs paid or incurred after December 31, 1975.

#### *D. Movies and Similar Property*

The committee decided to apply LAL to motion picture films and similar property on a property-by-property basis. Under this provision, the accelerated deductions for motion picture films and similar productions may not currently be deducted to the extent they exceed the taxpayer's income from the film. The inclusion by the committee of depreciation as an accelerated deduction means that LAL will apply to the "film purchase" shelter in which a limited partnership is formed to purchase a film and the partners claim a substantial depreciation deduction in the earlier years. To deal with the problem of the "production company" type shelter (in which a limited partnership is formed to produce a motion picture and deducts the costs of production as they are paid), the committee included production costs as an accelerated deduction subject to LAL.

Costs and expenses which may not be deducted currently would be accumulated in a deferred deductions account and will be deductible when the taxpayer receives income from the film or similar property. In the case of a movie film or similar property, the deferred deduction account terminates at the close of the seventh taxable year following the year in which the film is placed in service; the taxpayer may then claim accumulated deferred deductions with respect to that property at that time.

In the case of depreciation (i.e., the film purchase shelter), the LAL provision generally applies to all films except those where the principal production began before September 11, 1975, for which a binding written contract for the purchase of the film was also executed before that date. In the case of production costs (i.e., the production company shelter), the LAL provision is to apply to all films and similar property except those where the principal production began before September 11, 1975.

#### *E. Equipment Leasing*

The committee also decided to apply LAL to equipment leasing on a property-by-property basis. Under this provision the accelerated deductions attributable to an equipment lease will be deferred to a later year to the extent that they exceed the net related income from that property. Net related income from a leased property is gross income from the property less the "ordinary deductions" from the property (deductions other than the accelerated deductions). The LAL limitation is not to apply to true economic losses (not attributable to accelerated deductions) which will continue to be deducted currently.

The accelerated deductions to be taken into account under LAL for equipment leasing are the deductions claimed for accelerated depreciation and amortization to the extent these deductions exceed those allowable under the straight-line depreciation method and also the 20 percent variance allowed in the depreciation class lives. This definition reflects the committee's decision to consider the use of shortened depreciable lives for leased equipment, under the Asset Depreciation Range rules, as a facet of the accelerated deductions.

Generally, accelerated deductions in excess of net related income from the leased property will be required to be deferred to later taxable years when net related income exceeds the accelerated deductions from the property for later years, and the deferred deductions will be allowed only to the extent of the excess net related income in the subsequent years.

The committee decision applies LAL to individuals, estates and trusts, and subchapter S corporations. In addition, the LAL rules will apply both to so-called "net lease" financing transactions as well as to the types of equipment leases known as "operating" leases.

LAL will apply to equipment leasing transactions entered into after September 10, 1975, other than transactions subject to binding written agreements in effect on September 10, 1975, or transactions where the leased property was ordered by the lessor or lessee 6 months or more prior to such date and is first placed in service on or before December 31, 1975.

## TITLE II—OTHER TAX SHELTER AMENDMENTS

### Sec. 201. Recapture of depreciation on real property.

In the case of residential real estate (including Federal or State subsidized low-income housing), the committee provided for the complete recapture of all depreciation in excess of straight-line depreciation to the extent of any gain realized at the time of the sale of such property. (This rule already applies in the case of nonresidential property.) This provision will be effective with respect to all accelerated depreciation attributable to taxable years beginning after December 31, 1975 (regardless of the date the property was constructed).

### Sec. 202. Gain from dispositions of interests in oil and gas property.

To prevent the conversion of ordinary income into capital gain, the Committee decided to adopt a recapture provision, somewhat similar to those already adopted in the Code with respect to the recapture of depreciation. Under this provision, any gain on the disposition of an interest in oil or gas properties (or an interest in oil or gas partnerships) is treated as ordinary income to the extent of the excess of the intangible drilling deductions taken with respect to those properties over the deductions that would have been allowed had the expenses been capitalized.

These rules would apply to costs paid or incurred after December 31, 1975.

### Sec. 203. Repeal of farm excess deductions account.

Because farm losses were included in the limitation on artificial losses, the committee decided to repeal the provisions relating to farm excess deduction accounts.

### Sec. 204. Method of accounting for corporations engaged in farming.

The committee decided that corporations carrying on farm operations—other than subchapter S corporations and family corporations—are for tax purposes to be required to use accrual and inventory accounting methods for their farm operations. A family corporation for this purpose is defined as one where at least 75 percent of the voting stock and 75 percent of the total stock in a corporation are owned by a single family, including brothers and sisters, spouses, ancestors and lineal descendants, an estate of any of these family members and trusts for the benefit of such family members. For purposes of the family corporation rule, the committee decided to include two families (in the case of existing holdings) and to apply attribution through corporations. A corporation electing the exception under this provision will be subject to the LAL rules on farm losses.

This provision is to apply after 1975. In this case, however, corporations will be allowed 10 years to spread the accounting adjustments required by this change in method.

**Sec. 205. Treatment of prepaid interest.**

The committee agreed to provide that taxpayers using the cash method of accounting may deduct prepayment of interest only in the period to which it relates under the accrual method of accounting. Points (that is additional interest charges which are usually paid when the loan is closed and which are generally in lieu of a higher interest rate) would be required to be deducted ratably over the term of the loan, except in the case of a mortgage secured by the taxpayer's principal residence. In addition, the committee agreed to include in the prepayment of interest rule any prepayment involved in a wrap-around mortgage. In the case of loans with variable interest rates, the committee also indicated that a statement is to go in the committee report directing the Treasury Department to make a determination as to when higher interest charges in earlier years of a loan are in effect a prepayment of the interest which should relate to later years. This rule would also cover other items that are in effect a prepayment of interest; for example, a loan commitment fee (usually treated as an ordinary business expense) which is higher than would normally be the case.

These provisions are to apply to any prepayment of interest after September 16, 1975.

**Sec. 206. Limitation of the interest deduction for nonbusiness interest to a specified amount where it is claimed as an itemized deduction.**

The committee decided to limit the amount of interest an individual can claim as a deduction for nonbusiness interest (including investment interest) to \$12,000 a year. In the case of a loan for investment purposes, interest on the loan is to be deductible to the extent of the investment income, in addition to the \$12,000 allowable as a deduction under the general rule. Deductions for interest on investment loans which cannot be utilized (due to the limitation outlined above) are to be available as carryforwards and deductible in future years to the extent of related investment income in those years. Interest on borrowings incurred in connection with the taxpayer's trade or business is not to be subject to these rules and would continue to be deductible as under present law.

These rules are to apply to interest paid or incurred in years beginning after December 31, 1975.

**Sec. 207. Limitation of loss with respect to motion picture films to the amount for which the taxpayer is at risk.**

To deal with the problem of leverage, the committee decided to limit the deduction of losses in the case of motion picture films and similar property to the amount for which the taxpayer is "at risk," excluding all nonrecourse loans. This proposal affects the leverage factor which is present both in the film purchase shelter and the production company shelter.

The "at risk" provision is to apply to all films unless there is a binding written agreement which provides nonrecourse financing for the film in question which agreement is entered into before September 11, 1975, or where the principal production began before that date.

**Sec. 208. Deduction for intangible drilling and development costs allowable only to taxpayers at risk.**

To deal with the problem of leverage, the Committee decided to add a provision which would limit the amount of the deduction for in-

tangible drilling and development costs attributable to a property to the amount for which the taxpayer is at risk with respect to that property. In other words, a taxpayer would be allowed a deduction equal to his own equity investment in the partnership, but he would not be allowed to deduct expenses paid out of borrowed funds, unless the taxpayer had personal liability with respect to those borrowings.

These rules would apply to costs paid or incurred after December 31, 1975.

**Sec. 209. Player contracts in case of sports enterprises.**

*Allocation of purchase price to player contracts*

The committee agreed to provide that the portion of the amount paid to purchase a sports team or group of assets which would be allocable to player contracts or sports enterprises must be specified. The provision would have a presumption that no more than 50 percent of the purchase price could be allocated by the buyer to players' contracts unless the buyer can establish under the facts and circumstances of the case that the players' contracts involved do have a value in excess of 50 percent of the purchase price. In addition, the amount allocable to player contracts by a purchaser could not in any event exceed the amount of the sales price allocated to these contracts by the seller.

*Recapture of depreciation on player contracts*

In the case of player contracts or sports franchises, the committee agreed to clarify present law by providing that there would be a complete recapture of all depreciation to the extent of any gain involved at the time of the sale of the player contract or of the sports enterprise.

**Sec. 210. Certain partnership provisions.**

The committee agreed to several revisions of the partnership tax rules. First, it specifically limited the extent to which a partnership may allocate income and loss generally and also items of income, gain, loss, deduction or credit among the partners. Generally, income, loss or these specific items are to be allocable to a partner only if they are paid or incurred (by the partnership) during the portion of the year in which he is a member of the partnership. In determining whether income, loss or a special item has been paid or incurred prior to a partner's entry into a partnership, the partnership may either allocate ratably on a daily basis or, in effect, separate the partnership year into two (or more) segments and allocate income, loss, or special items in each segment among the persons who were partners during that segment.

Second, the committee decided that income, losses, or items of income gain, loss, deduction or credit generally must be allocated among the partners (1) in the same way income is allocated if there is a permanent method for allocating income, or (2) if there is not such a permanent allocation of income, on the basis of the partners' capital. This rule will not apply, however, if the partner receiving the special allocation can establish that there is a business purpose for allocating the loss or item otherwise and no significant tax avoidance results from this allocation.

Third, the committee agreed to limit the amount of additional first-year depreciation that a partnership can pass through to its partners in any taxable year. Under present law, an owner of tangible personal

property may elect a deduction for additional first-year depreciation of 20 percent of the cost of the property, not to exceed \$10,000 (\$20,000 for a joint return). Thus, the maximum bonus depreciation deduction is \$2,000 (\$4,000 for a joint return). In the case of partnerships (as contrasted to corporations) the dollar limitation is applied separately with respect to each partner rather than once at the level of the partnership. The committee agreed to impose a limitation of \$2,000 on the amount of additional first-year depreciation at the partnership level as well as at the partner level. Thus, a partnership can pass through to each partner their pro rata share of the \$2,000 bonus depreciation allowance. An individual then would aggregate all of the additional first-year depreciation from all partnerships in which he was a member, but this aggregate amount for which deductions may be taken may not exceed \$2,000 (or \$4,000 in the case of a joint return).

Finally, the committee decided to make it clear that fees for the organization and syndication of a partnership must be capitalized.

These provisions, except to the extent they are declaratory of existing law, are to be effective for taxable years beginning after December 31, 1975.

**Sec. 211. Scope of waiver of statute of limitations in case of hobby loss elections.**

In giving the taxpayer an opportunity to determine whether the rule of present law limiting deductions incurred in an activity which is not engaged in for profit (sec. 183) on the basis of his experience in a 5- or 7-year period, the committee decided to limit the waiver of the statute of limitations in these cases so that the waiver does not apply to unrelated items on the taxpayer's return.

### TITLE III—MINIMUM TAX FOR INDIVIDUALS

#### Sec. 301. Minimum tax for individuals.

The Committee agreed to a series of changes in the minimum income tax. These would retain the basic format of the existing minimum tax but would alter several features of it. The changes apply only to the minimum tax on individuals, estates, and trusts. There are no changes in the existing minimum income tax on corporations (other than subchapter S corporations).

The existing minimum tax is equal to 10 percent of the sum of 9 items of tax preference, reduced by a \$30,000 exemption and the taxpayer's regular income tax. A 7-year carryforward is allowed for the amount of the taxpayer's regular income tax that is not needed to offset preference income in the year the regular tax is owed.

Under the Committee's tentative decision, the \$30,000 exemption would be lowered to \$20,000. Furthermore, the exemption is to be reduced dollar-for-dollar as preference income exceeds \$20,000, so that it would vanish entirely when preference income exceeds \$40,000. For example, an individual with preference income of \$25,000 would have a \$15,000 exemption (\$20,000 minus \$5,000).

The Committee agreed to increase the rate of the minimum tax from 10 percent to 14 percent.

The Committee also agreed to reduce the deduction under the minimum tax for regular income taxes from 100 percent of the regular taxes to 50 percent (not to exceed one-half of preference income after the exemption). The Committee also agreed to eliminate the carryover of regular taxes that are not needed to offset preference income in a year.

The Committee also made three changes in the items of tax preference subject to the minimum tax. A preference item was added for itemized deductions in excess of 70 percent of adjusted gross income. Also, the Committee added to the list of preferences intangible drilling costs on development wells in excess of those that would be deductible if the intangible drilling costs were capitalized and deducted over the life of the well. However, these costs are only to be included in the minimum tax to the extent that they are not deferred under the proposal for a limitation on artificial losses. Similarly, the Committee deleted from the minimum tax accelerated depreciation and any other accelerated deductions that are deferred under the limitation on artificial losses.

These revisions are to apply on or after January 1, 1976.

**TITLE IV—EXTENSIONS OF INDIVIDUAL INCOME TAX  
REDUCTIONS**

**Sec. 401. Extension of individual income tax reductions.**

(The committee has not as yet made any decision with respect to the individual income tax reductions.)

**TITLE V—TAX SIMPLIFICATION IN THE INDIVIDUAL  
INCOME TAX**

**Sec. 501. Revision of tax tables for individuals.**

The committee revised the optional tax tables so that taxpayers will use a simplified table. The new tables are to be based on taxable income instead of adjusted gross income and, as a result, 4 tax tables are to replace the 12 existing optional tax tables. Also, the tax tables are to apply to taxable incomes up to \$20,000 of taxable income (instead of \$10,000 of adjusted gross income) and are to be available both to those who itemize and to those who take the standard deduction.

The new tables are to apply for years beginning after December 31, 1975.

**Sec. 502. Deduction for alimony allowed in determining adjusted gross income.**

The committee agreed to change the deduction for alimony payments from an itemized deduction to a deduction from gross income in arriving at adjusted gross income. This revision makes the alimony deduction available to taxpayers who elect the standard deduction, as well as those who itemize their deductions.

The change is to be effective for years beginning after December 31, 1975.

**Sec. 503. Repeal of deduction for state and local taxes on gasoline and other motor fuels.**

The committee agreed to repeal the deduction for State and local taxes paid by a taxpayer for the purchase of gasoline, diesel fuel and other motor fuels for nonbusiness use. (The business expense deduction for gasoline, etc., including the tax, still remains available.)

The deduction is repealed for years beginning after December 31, 1975.

**Sec. 504. Revision of retirement income credit.**

The committee decided to restructure the present retirement income credit and convert it to a tax credit for the elderly, available to all taxpayers age 65 or over regardless of whether they have retirement income or earned income. The maximum amount on which the credit is computed is increased to \$2,500 for single persons age 65 or over (or for married couples filing joint returns where only one spouse is age 65 or over) and to \$3,750 for married couples filing joint returns where both spouses are age 65 or over. Under present law, the maximum amount on which a credit is computed in the case of a single person is \$1,524; for a married couple, the maximum amount is \$2,286 in the case of one "retirement income" recipient and \$3,048 in the case of two recipients.

These maximum amounts for computing the credit are reduced under present law by social security benefits and other exempt pension income. Present law also reduces the credit by one-half the earnings

over \$1,200 and under \$1,700, and by all the earnings over \$1,700. The committee decided to eliminate this earnings cut-back (but not the cutback for social security benefits and other tax-exempt pension income) and provide an income phaseout based on adjusted gross income (rather than just earned income) above \$7,500 for single persons and \$10,000 for married couples to limit the benefits of the credit to low- and middle-income elderly taxpayers. Under this phaseout, the maximum amount on which the credit is computed is reduced by \$1 for each \$2 of adjusted gross income (AGI) above the indicated AGI levels.

The committee also agreed to eliminate the provisions of present law that limit the credit based on the amount of a taxpayer's retirement income; thus, the credit will also be allowed for earned income.

In addition, the committee agreed to eliminate the requirement that to be eligible for the credit, the taxpayer must have met the test of earning \$600 a year for 10 years. Further, the variation in treatment of married couples depending on whether they are separately eligible for the credit is eliminated.

The committee raised the maximum amount on which the credit may be computed in the case of individuals under 65 who receive public retirement pensions to \$2,500 for single persons and \$3,750 for married couples. It also eliminated for people under 65 the 10-year, \$600 earnings requirement and the variation in treatment of married couples.

This change is to apply for years beginning after December 31, 1975.

#### **Sec. 505. Credit for child care expenses.**

The committee agreed to a series of modifications which should simplify and broaden the provision for household and dependent care services necessary for a taxpayer to work. The committee tentatively agreed to replace the itemized deduction for household and dependent care expenses with a nonrefundable income tax credit. The committee agreed to allow a credit against tax for 15 percent of expenses incurred for the care of a child under age 15 or an incapacitated adult, in order to enable the taxpayer to work. The income limit of \$18,000 (\$35,000 for 1976 and after) over which the deduction is phased out is to be removed. These changes will increase the number of taxpayers deducting such expenses because the credit will be available without regard to income level and will be extended to taxpayers claiming the standard deduction who are presently unable to deduct such expenses.

Several changes were also agreed to by the committee to simplify the tax return form by eliminating the need for a separate child care schedule. One such change replaces the present monthly maximum deduction (\$200 for one dependent, \$300 for two dependents, and \$400 for three dependents) with a maximum annual deduction of \$2,400 for one dependent and \$4,800 for two or more dependents. With a 15 percent credit, the maximum credit would be \$360 for one dependent and \$720 for two or more.

The committee also agreed to extend the credit to married couples, where the husband or wife, or both, work part-time. (Presently, both are required to work full-time.) The eligible expenses are to be limited to the amount of earnings of the spouse earning the smaller amount,

or in the case of a single person, to his or her earnings. The deduction also is to be made available to married couples where one is a full-time student and the other spouse works.

The committee also decided to eliminate the distinction between care in the home and care outside the home. The credit also is to be extended to a divorced or separated parent who has custody of a child even though the parent may not be entitled to a dependency exemption for the child. A deserted spouse is to be eligible for the credit when the deserting spouse is absent for 6 months instead of an entire year. Finally, the requirement that the deduction for the taxpayer be reduced by disability income received by his dependent is to be eliminated.

These changes are to apply for years beginning after December 31, 1975.

**Sec. 506. Changes in exclusions for sick pay and certain military, et cetera, disability pensions.**

The committee agreed to a significant revision of the sick pay exclusion provision and the treatment of military disability payments for future members of the Armed Services.

The committee decided to repeal the present sick pay exclusion which involves complicated time and percentage rules, and to substitute a maximum annual exclusion of \$5,200 (\$100 a week) for taxpayers under age 65 who are permanently and totally disabled. (After that age, they will be eligible for the revised elderly credit.)

The maximum amount of income which may be excluded as disability income under the revised sick pay exclusion is limited to \$100 a week (\$5,200 a year), the same amount as allowed under present law. The maximum amount excludable is to be reduced on a dollar-for-dollar basis by the taxpayer's income (including disability income) in excess of \$15,000. These new rules will apply to both civilians and military personnel.

The changes in the tax treatment of military disability payments affect only payments made to future members of the armed services. At all times, Veterans' Administration disability payments will continue to be excluded from gross income. In addition, even if a military retiree does not receive his disability benefits from the Veterans' Administration, he will still be allowed to exclude from his gross income an amount equal to the benefits he could otherwise receive from the Veteran's Administration. Otherwise future members of the armed services will be allowed to exclude military disability retirement payments from their gross income only if the payments are directly related to "combat injuries." A combat-related injury is defined to be an injury or sickness which is incurred (1) as a direct result of armed conflict; (2) while engaged in extrahazardous service; (3) under conditions simulating war; or which is (4) caused by an instrumentality of war.

All persons who were members of the armed services or military retirees as of September 24, 1975, and who received military disability retirement payments which are excluded from their gross income under present law, will continue to exclude such payments from gross income under the committee's tentative decision.

The sick pay revisions are to apply to civilians and military personnel on or after January 1, 1976. The military disability revisions will apply to individuals who enter the armed services on or after September 25, 1975.

**Sec. 507. Moving expenses.**

The committee agreed to several changes in the deduction for the expenses of moving to a new residence in connection with beginning work at a new location. The committee increased from \$1,000 to \$1,500 the maximum deduction for premove househunting and temporary living expenses at the new job location and increased from \$2,500 to \$3,000 the maximum deduction for qualified expenses for the sale, purchase or lease of a residence (reduced by any deduction claimed for househunting or temporary living expenses). The committee also reduced to 35 miles the mileage limitation which requires that a taxpayer's new principal place of work must be at least 50 miles further from his former residence than was his former principal place of work.

The committee agreed in the case of members of the armed forces to eliminate the requirement that they report as income any moving expenses for which they are reimbursed (or for which they are provided in-kind services) by the Department of Defense and which would otherwise qualify as deductible expenses. The committee also exempted members of the armed services both from the mileage limitation and from the "39-week rule" which requires that a taxpayer be a fulltime employee in the new general location for at least three-fourths of the following year (that is, 39 weeks during the next 12-month period).

The changes will apply to taxable years beginning after December 31, 1975.

**TITLE VI—BUSINESS RELATED INDIVIDUAL INCOME  
TAX PROVISIONS**

**Sec. 601. Deduction of expenses attributable to business use of homes, rental of vacation homes, etc.**

*Business Use of Home*

The committee agreed to provide definitive rules for permitting deductions of expenses attributable to the use of a taxpayer's home for business purposes. The taxpayer will not be permitted to deduct any expenses attributable to the use of his home for business purposes except as provided below.

The committee provided for two situations in which such expenses attributable to the use of a portion of the taxpayer's residence for business use will be permitted. Deductions will be permitted with respect to the portion of the home that is used exclusively on a regular basis as:

- (1) the taxpayer's principal place of business, or
- (2) a place of business which is used for patients, clients, or customers in meeting or dealing with the taxpayer in the normal course of business.

However, under these two exceptions, the deduction for allowable expenses may not exceed the income generated by the business activities of the taxpayer in his home. In addition, in the case of an employee, the business use must be for the convenience of the employer.

This provision is to apply after December 31, 1975.

*Vacation Home*

The committee agreed to provide that if a vacation home is used by a taxpayer for personal purposes for the greater of two weeks or five percent of the actual business use (that is its actual rental time), then Section 183 would be applicable (whether or not the presumption under present law would otherwise apply). This means that the applicable deductions incurred in connection with a vacation home, which would be allowed if the activity were engaged in for profit, are not to exceed the gross income from the business use of the vacation home. In addition, where the two weeks or five percent rule applies (or sec. 183 otherwise applies), the deductions treated as being attributable to the rental activities would be limited to the proportion which actual rental use bears to the total actual use of the property (that is, business use plus personal use) times the business expenses attributable to the vacation home (other than expenses which are allowable in any event).

These special rules will not apply if the rental of a vacations home results in a profit for the year.

This provision is to apply after December 31, 1975.

**Sec. 602. Deduction for conventions, conferences, etc., outside the United States.**

The committee agreed to limit deductions allowable for the expenses of taxpayers attending conventions, educational seminars, or similar meetings outside the United States, including its trust territories, and possessions. First, the committee agreed that deductions would be allowed for expenses incurred in attending not more than two conventions per year which are held outside the United States. Further, with respect to these two conventions, the amount of the deduction for transportation expenses may not exceed the cost of airfare based on coach or economy class and the amount of the deduction for expenses other than transportation expenses cannot exceed the fixed amount of per diem allowed to government employees at the location where the convention, etc., is held.

This provision will apply to conventions held after December 31, 1975.

**Sec. 603. Qualified stock options.**

The committee agreed to modify the tax treatment with respect to qualified stock options. Under present law, a qualified stock option is not treated as income when it is granted or when it is exercised. In addition, when the stock acquired under the option is sold or exchanged by the employee, the difference between the option price and the price received by the employee is generally treated as long-term capital gain or loss.

The committee revised this treatment, so that in the future, qualified stock options will be subject to the rules of section 83 of the Internal Revenue Code (which applies today in the case of most nonqualified options granted after June 1969). Generally, the value of the option would constitute ordinary income to the employee if it had a readily ascertainable fair market value at the time it was granted (and was not nontransferable and subject to a substantial risk of forfeiture). If the option did not have a readily ascertainable value, it would not constitute ordinary income at the time it was granted, but when the option was exercised the spread between the option price and the value of the stock would constitute ordinary income to the employee.

In general, the new rules are to apply to options granted after September 23, 1975, but are not to apply to options granted on or before this date. This is true even though the option is exercised in the future (so long as it meets the terms of the present rules of a qualified option). In addition, the committee agreed to include transition rules for options granted after September 23, 1975, pursuant to a written plan adopted and approved before September 24, 1975; for options granted after September 23, 1975, under a qualified plan adopted by a board of directors before September 24, 1975, even if the plan was approved by the shareholders after that date; and for substitute options granted after September 23, 1975, as a result of a corporate reorganization or similar transaction provided that no modification of the former option occurs. The transition rules cover these options as long as they exercised before September 24, 1980 (no matter when the option is granted in accordance with the plan).

The committee did not revise the rules with respect to employee stock purchase plans which provide that stock under the plan must be

made available to all the employees of a corporation on a nondiscriminatory basis.

**Sec. 604. Deduction for guarantees of business bad debts to guarantors not involved in business.**

Under present law business bad debts are deductible in the case of a noncorporate taxpayer as ordinary losses for the year the debt becomes worthless or partially worthless. On the other hand, nonbusiness bad debts are treated as short-term capital losses. This means that these losses are first offset against the taxpayer's capital gain (if any), and then are offset against ordinary income to the extent of \$1,000 per year. However, where the noncorporate taxpayer's loss results from a situation where he guaranteed the debt of a noncorporate person, and was required to make good on that guaranty because the borrower defaulted, present law provides that the guarantor may treat the payment under the guaranty as a business bad debt (even though the guaranty did not arise in connection with the guarantor's trade or business) if the proceeds of the loan were used by the borrower in his trade or business.

The committee decided that where a taxpayer has a loss arising from the guaranty of a loan, he is to receive the same treatment as where he has a loss from a loan which he makes directly. Thus, if the guaranty agreement arose out of the guarantor's trade or business, the guarantor would still be permitted to treat the loss as an ordinary loss. If the guaranty agreement were a transaction entered into for profit by the guarantor (but not as a part of his trade or business), he would treat the loss as a short term capital loss. Under the committee decision, this rule is also to apply in the case of a guarantor of a corporate obligation.

These rules would apply to taxable years beginning after December 31, 1975.

**Sec. 605. State and congressional legislators.**

The committee provided that the home of a member of a State legislature, for purposes of trade or business expenses paid in connection with his position as a State legislator, is to be his place of residence within the district he represents. However, this treatment is to be allowed only to the extent of living expenses paid while away from home in an amount not to exceed \$44 per day for each day the State legislature is in session or for each day the State legislator attends a session of a committee of that State legislature. (The \$44 a day is the amount presently deductible by businessmen for travel away from home without the requirement of substantiation to anyone other than their employer.)

Present law applies a similar rule as to what constitutes home for tax purposes to a Member of the U.S. Congress, but limits to no more than \$3,000 the deductions that may be taken in any year. The committee modified this \$3,000 limitation to provide that a Member of the U.S. Congress is to be allowed to deduct an amount not to exceed \$44 per day for each day that the House or Senate (as the case may be) is in session, but only if the individual legislator is present at that session.

This provision is to be effective for taxable years after December 31, 1975.

## TITLE VII—ACCUMULATION TRUSTS

### Sec. 701. Accumulation trusts.

For the two alternative methods used in computing the throwback rule for accumulation distributions, the committee agreed to substitute a single method, a revision of the present "short cut method." This method throws the average accumulation distributions (as determined under present law) back to the 5 preceding years of the beneficiary (rather than the 3 preceding years under present law). Of these 5 preceding years, however, the year with the highest expanded taxable income and the year with the lowest will not be considered (in effect, then, the computation of the additional tax on the accumulation distribution under this short cut method will continue to be based on a 3-year average basis). The average amount for the 3 years will be added to the beneficiary's taxable income for these years (rather than requiring the recomputation of his tax returns as under present law). In other respects, the present rules under the short cut method are to continue to be applicable, except that no refunds are to be available.

Income accumulated by a trust prior to the beneficiary's attaining the age of 21 and the years a beneficiary was not in existence are not to be subject to the throwback rule.

A special rule is provided for 3 or more trusts which accumulate income in the same year for a beneficiary.

The capital gains throwback rule is to be repealed. A special rule is provided to cover the possible tax abuse where the grantor places in trust property which has unrealized appreciation in order to shift the payment of tax to the trust at its lower progressive rate structure. In this case the property is to have a new 2-year holding period which is to apply to the unrealized appreciation in the property at the time it is placed in trust. The appreciation in the property during the time it is held in trust is to come under the normal holding period rules. This special rule is not to apply to property placed in charitable remainder trusts or pooled income funds.

These changes are to apply to accumulation distributions made in taxable years beginning after December 31, 1974.

**TITLE VIII—INVESTMENT CREDIT CHANGES**

**Sec. 801. Investment credit changes.**

(The committee has not as yet made any decision with respect to investment credit changes.)

**TITLE IX—CORPORATE RATES**

**Sec. 901. Corporate rates.**

(The committee has not as yet made any decisions with respect to corporate rate reductions.)

**TITLE X—CHANGES IN THE TREATMENT OF  
FOREIGN INCOME**

**Part I—Amendments Primarily Affecting Individuals**

**Sec. 1011. Income earned abroad by U.S. citizens living or residing abroad.**

The committee agreed generally to phase out over a 4-year period the exclusion of \$20,000 (or \$25,000) of income earned abroad for U.S. citizens living or residing abroad (by lowering the exclusion by \$5,000 or \$6,250 each year). However, it agreed to retain the \$20,000 exclusion for employees of U.S. charitable organizations (section 501(c)(3) organizations). Also, employees working on fixed price construction projects where work has already begun or where binding contracts already exist are to receive the exclusion during the period of the contract, but not for more than 4 years. In those cases where the exclusion is not available, the committee agreed to a deduction of up to \$1,200 for elementary and secondary school expenses of dependents of U.S. taxpayers employed outside the United States and also to an exclusion from gross income of amounts paid for municipal-type services furnished in a foreign country by an employer on a non-discriminatory basis. Present law is to be modified to allow a foreign tax credit to individuals claiming the standard deduction.

It also agreed to phase out over a 4-year period the exclusion from tax of the various allowances for Government employees working overseas. However, these employees will be eligible for the educational expense deduction and the income exclusion for municipal-type services discussed above.

**Sec. 1012. U.S. taxpayers married to nonresident aliens.**

The committee agreed to allow U.S. taxpayers married to nonresident aliens to file joint returns with their spouse if an election is made by both taxpayers to be taxed on their worldwide income and if the taxpayer makes available the necessary books and records. Community property laws for income tax purposes are not to apply to taxpayers married to nonresident aliens whether or not they make this election.

**Sec. 1013. Grantor trust rule.**

The committee agreed to adopt a new rule under which U.S. grantors of foreign trusts with U.S. beneficiaries are to be taxed currently on the income of these trusts (under the grantor trusts rules of current law). The rule is to apply to trusts established after May 21, 1974, for taxable years ending after December 31, 1975.

**Sec. 1014. Interest charge.**

In all other cases the committee agreed that U.S. beneficiaries of foreign trusts are to pay interest charges on the U.S. taxes on any accumulation distributions received which are subject to U.S. tax. The interest charge is to apply to distributions made after December 31, 1975.

**Sec. 1015. Transfers to foreign trusts and other entities.**

The committee extended the excise tax on transfers of stocks and securities to foreign entities to transfers of all other types of property, made it clear that this tax applies only to the unrealized appreciation, and increased the rate of this tax from 27½ percent to 35 percent. These changes apply to transfers made after October 2, 1975.

The committee also instructed the staff to study the need for further reporting of information on foreign trusts.

**Part II—Amendments Affecting Tax Treatment of Controlled Foreign Corporations and Their Shareholders****Sec. 1021. Investment in U.S. property.**

The Committee limited the definition of investments in U.S. property by controlled foreign corporations (which are treated as dividends) to investments in stock or obligations of a related U.S. person (not including a subsidiary) and to tangible property leased to, or used by, such a related U.S. person. However, sales between a controlled foreign corporation and a related U.S. person which are disguised dividends are to be considered as investments in U.S. property. The new rules are to be prospective except that they are to apply as of 1969 in the case of foreign corporations owning U.S. subsidiaries investing on the U.S. Continental Shelf.

**Sec. 1022. Earnings of less-developed country corporations.**

The committee eliminated the provision in present law excepting the U.S. shareholders of less-developed country corporations from ordinary income tax on gain from the sale of stock of those corporations (to the extent of their accumulated profits). This applies to sales after December 31, 1975, with respect to earnings accumulated after that date.

**Sec. 1023. Foreign personal holding company income.**

The committee agreed to add an exception to the definition of foreign personal holding company income for income on earned surplus which must be retained by a foreign casualty insurance subsidiary in order to satisfy State insurance solvency requirements as to earned premiums. This exception is to apply to taxable years beginning after December 31, 1975.

**Part III—Amendments Affecting Treatment of Foreign Taxes****Sec. 1031. Per country limitation.**

The committee agreed to repeal the "per country" limitation on the foreign tax credit for all taxpayers for taxable years beginning after December 31, 1975.

**Sec. 1032. Recapture of foreign losses.**

The committee agreed to provide for the recapture of all foreign losses offset against U.S. income when, and to the extent, foreign income is earned in future years. The provision is to apply to losses incurred in taxable years beginning after December 31, 1975.

**Sec. 1033. Dividends from less-developed country corporations.**

The committee agreed to require that dividends received by U.S. shareholders from less-developed country corporations be "grossed

up" by the amount of taxes paid to less-developed countries for purposes of computing the foreign tax credit and the related foreign source taxable income.

**Sec. 1034. Treatment of capital gains.**

The committee agreed that any capital gain from property sold outside of the country in which a company does most of its business (on outside the country of residence of the individual), if no substantial foreign tax has been paid on that income, for purposes of the foreign tax credit limitation is not to be treated as foreign source income. It also agreed to provide new rules for netting foreign source capital gains and losses with domestic source capital gains and losses in computing the foreign tax credit limitation, and to adjust the amounts to be included in the limitation for the lower corporate tax rate on capital gains income.

**Part IV—Money Or Other Property Moving Out of Or Into  
The United States**

**Sec. 1041. Investments by foreigners in the United States.**

The committee repealed the present 30-percent withholding tax on dividend and interest income received from the United States by foreign persons. This repeal is not to apply to payments from the Virgin Islands. It also made permanent the exemption in present law (which would expire after December 31, 1976) for interest on bank deposits in the United States. The exemption for interest and dividends is not to apply to direct investments by foreigners; i.e., those corporate investments in which foreigners control more than 50 percent of the U.S. corporation but only in the case of foreigners with stock holdings of 10 percent or more. This provision is to apply to payments made after the enactment of this legislation.

**Sec. 1042. Reorganizations involving foreign corporations.**

The committee eliminated the requirement of present law that an advance ruling from the IRS be obtained for reorganization-type transactions involving foreign corporations. For transactions which are solely foreign or those which involve the transfer of property into the United States, the IRS is to draft regulations by January 1, 1978, specifying the treatment of these transactions. For transfers of property out of the United States, individual rulings are still to be required, but these rules can be requested up to 183 days after the beginning of the transaction. In addition, these rulings are to be subject to Tax Court review. Finally, the provision of present law which taxes as ordinary income and the sale of stock in a foreign subsidiary (to the extent of accumulated earnings) is extended to apply to nontaxable transfers of stock (secs. 311, 336 and 337).

**Sec. 1043. Insurance companies operating in contiguous countries.**

Mutual life insurance companies maintaining separate operations in countries contiguous to the United States are to be permitted to treat these operations as if carried on through a foreign subsidiary. Under this provision a mutual company is to be treated as having transferred its assets to such a branch operating in the contiguous country and is to be subject to the normal tax requirements (of section 367) regarding transfers of property out of the United States for

tangible property assets except that losses are to be netted in determining the gain from these assets. In addition, stock life insurance companies are to be permitted to transfer the assets of their foreign branch operations in contiguous countries to foreign subsidiaries under these same section 367 rules.

**Part V—Puerto Rico and Possessions Corporations; Western Hemisphere Trade Corporations; China Trade Act Corporations**

**Sec. 1051. Possessions corporations.**

The committee modified the tax treatment of "possessions" corporations by providing a new tax credit for them in lieu of the income exclusion provided under present law. The tax credit would equal the U.S. tax attributable to a corporation's income from a possessions trade or business and from qualified possessions investments. Other income of a possessions corporation would be subject to U.S. tax. U.S. corporations receiving dividends from possessions corporations would be eligible for the 85- or 100-percent dividends-received deduction. Corporations would qualify as possessions corporations only if they elect for a period of 10 years to remain in that status.

**Sec. 1052. Western Hemisphere trade corporations.**

The committee phased out over a 5-year period the provision of present law which permits a 14-percent lower tax rate for Western Hemisphere trade corporations.

**Sec. 1053. China Trade Act corporations.**

The committee phased out over a 4-year period the provisions of present law permitting special tax treatment for China Trade Act corporations and their shareholders.

**Part VI—Amendments Affecting Tax Treatment of Shipping Income**

**Sec. 1061. Shipping into and out of the United States.**

Beginning in 1977, the exclusion for shipping income provided under present law is to be repealed and U.S. source rules are to be modified so that one-half of the taxable income from shipping into and out of the United States is treated as domestic source income. This provision is not to terminate provisions of existing tax treaties in 1977. Instead, the Treasury Department is to have an opportunity throughout 1977 to revise our treaties to make them consistent with the rule set out above. In cases where a foreign shipper is not willing to file a return to pay any U.S. tax due (and make his books available to the IRS), the IRS may assess a tax of 5 percent of the shipping charges on the cargo loaded or unloaded in the United States by the shipper.

**Sec. 1062. Foreign base shipping income.**

The committee agreed to modify the tax haven (or subpart F) provisions to exclude from the definition of foreign base shipping income shipping between two or more points within the country of incorporation and registration of the ships. Also amounts paid on unsecured loans by companies substantially all of whose assets are in shipping is to be treated as a reinvestment in shipping assets for purposes of subpart F.

**TITLE XI—AMENDMENTS AFFECTING DOMESTIC  
INTERNATIONAL SALES CORPORATIONS**

**Sec. 1101. Domestic International Sales Corporation.**

*A. Agricultural products and military equipment*

The committee eliminated from DISC treatment products sold for use as military equipment and also agricultural products not in surplus in the United States.

*B. Computation of DISC benefits*

For taxable years beginning after December 31, 1975, DISC benefits generally are to be allowed only to the extent that the DISC's net income for the year exceeds 75 percent of its base period income. From 1976 through 1980, the base period is to be average DISC net income of the corporation in the years 1972, 1973, and 1974. Beginning in 1981 this base period is to move one year forward each year. Companies whose total DISC benefits are less than \$100,000 per year are not to be subject to the new base period method of computation, but instead may calculate their DISC benefits as provided by present law.

*C. Modification of provisions of Tax Reduction Act of 1975*

Taxpayers for whom DISC benefits were repealed under the Tax Reduction Act of 1975 are to continue to receive DISC benefits for exports made pursuant to binding contracts written after the company's DISC was established but before March 18, 1975, but only if the contracts have both fixed price and fixed quantity requirements. This binding contract rule is to apply for 5 years from March 18, 1975. The provision in the Tax Reduction Act of 1975 providing that DISC tax treatment is not to be available if the commodity involved is a natural resource subject to the allowance of cost depletion is changed to eliminate DISC benefits for those items subject to the allowance of percentage depletion.

## TITLE XII—ADMINISTRATIVE PROVISIONS

### Sec. 1201. Income tax return preparers.

The committee adopted the provisions originally agreed to last year relating to income tax return preparers, with three modifications. First, the committee added a prohibition against income tax preparers' endorsing any check received by a taxpayer from the IRS; a civil penalty of \$500 would be imposed by the IRS for violation of this provision. In addition, the committee added as a ground for seeking a court injunction against a preparer the action of a preparer in endorsing a taxpayer's check from the IRS. Finally, the committee modified the other grounds for seeking an injunction (under number 6 below) to limit them to specific types of conduct set out in the provision and to other types of conduct similar in nature to the specified types.

The provisions of last year's bill which were agreed to by the committee are as follows:

1. Each prepared return, statement or other document must contain the identification number of the return preparer and other data sufficient to identify the preparer. A \$25 penalty is provided for each failure to comply, if without reasonable cause.
2. Each preparer must furnish to a taxpayer a copy of the return or claim for refund prepared by the tax return preparer at the time the return is given to the taxpayer for his signature. A \$25 penalty is provided for failure to comply, if without reasonable cause.
3. Each return preparer or person employing a tax return preparer to prepare the returns of others must file an annual report with the IRS listing the name, address, identification number, and place of work of each preparer he employs. Failure to comply without reasonable cause would result in a \$100 penalty for each failure to file an annual return and a \$5 penalty for each failure to include a name, address, identification number and place of work in the annual report. These penalties are not to exceed \$20,000 for a 12-month period.
4. Each return preparer or employer of return preparers must retain for three years either a list of taxpayers for whom returns were prepared or copies of their returns and claims for refunds. A \$50 penalty is provided for each failure to retain a copy of a return or to list a taxpayer for whom a return was prepared, up to a maximum of \$25,000 for all returns in a year.
5. A \$100 penalty is provided for negligent or intentional disregard of Internal Revenue Service rules or regulations by a tax return preparer. \$500 penalty is provided for a willful attempt to evade, defeat or understate any tax by a tax return preparer. A separate penalty may be imposed for each return or claim for refund.
6. The IRS is given the authority to seek a court injunction against income tax return preparers (1) engaging in conduct subject to penalties, (2) misrepresenting their qualifications (including eligibility

to practice before the Internal Revenue Service), (3) guaranteeing the payment of a tax refund, or (4) engaging in other conduct similar in nature to the above types of conduct which substantially interferes with the proper administration of internal revenue laws. A tax return preparer who files a bond of \$50,000 to guarantee payment of further penalties would not be subject to an injunctive proceeding for penalty-type conduct.

7. The Internal Revenue Service would be authorized to provide the names, addresses, and taxpayer identifying numbers of preparers to State authorities charged with enforcing State provisions regulating tax return preparers.

**Sec. 1202. Declaratory judgments with respect to section 501 (c)(3) status and classification.**

The Committee agreed to provide a procedure whereby an organization may ask the United States Tax Court or a Federal district court for a declaratory judgment as to its tax-exempt status and classification under section 501(c)(3) of the Internal Revenue Code. Under this procedure, if the IRS revokes a prior favorable ruling or fails to issue a favorable ruling, the organization may petition the Tax Court or the district court for a declaratory judgment as to its exempt status as a religious, educational, charitable, etc., organization under section 501(c)(3), its classification as a private foundation or a private operating foundation, or its classification as an organization eligible to receive deductible charitable contributions.

The declaratory judgment procedure is to be available only to the organization seeking to establish its own status and then only when the organization has exhausted the administrative remedies reasonably available to it.

The Committee agreed that if the declaratory judgment involves a revocation of a prior favorable tax-exempt status decision, then deductions for contributions made to the organization after the IRS's announcement that contributions to the organization are no longer deductible and before the court's decision in the suit generally would not be disallowed merely because the court determined in that suit that the organization was not tax exempt. Except for very large amounts, contributors could obtain deductions for contributions made during the period between the IRS announcement and the court decision. However, no contribution deductions would be available during this period to any person who was responsible for the organization's actions or inactions that caused it to lose its charitable donee status.

This provision is to apply to pleadings or petitions filed with the Tax Court or district court more than one year after the date of enactment of this bill.

**Sec. 1203. Assessments in case of mathematical or clerical errors.**

The Committee decided to clarify the kinds of cases in which the IRS can make summary assessments in mathematical error cases; provide greater protection for taxpayers who wish to contest the Internal Revenue Service in these summary assessments cases; and, where the IRS determines a taxpayer owes additional taxes, require the Service to explain how it determined the taxpayer's additional liability.

Present law permits the IRS to summarily assess any additional tax resulting from correction of a mathematical error appearing on the return. To resolve disputes as to what is a "mathematical error"

and to reduce administrative costs by permitting expedited procedures to be used in more cases, the Committee agreed to allow summary assessments in the following five categories:

- (1) errors in addition, subtraction, etc., shown on the return;
- (2) incorrect use of an IRS table if the error is apparent from the return;
- (3) inconsistent entries on a return;
- (4) omission of information required to be supplied on the return in order to substantiate an item on that return; and
- (5) entry of a deduction or credit item in excess of the statutory limit (e.g., taking a standard deduction greater than the permitted maximum standard deduction).

If the IRS determines that there has been such an error, it is to notify the taxpayer, who has 90 days to dispute the IRS determination. If the taxpayer disputes the determination, the IRS has 60 days to decide whether its original determination was correct. If the IRS notifies the taxpayer within the 60 days that it intends to pursue the matter, the taxpayer has 30 days within which he can require the IRS to use the regular "notice of deficiency" procedure instead of this summary assessment procedure.

The Committee also decided that the IRS is to be required by statute to explain to the taxpayer just what adjustments it is making to the taxpayer's return when the IRS determines that the taxpayer has an additional tax liability.

**Sec. 1204. Voluntary withholding of state income taxes in the case of certain legislative officers and employees.**

The Committee agreed to require the paying officers of the House of Representatives to enter into agreements with requesting States to withhold State income tax from any members or employees of the House who request it.

**Sec. 1205. Withholding state and city income taxes from the compensation of members of the national guard or the ready reserve.**

The Committee extended the provision under present law requiring the Treasury to enter into agreements with States and cities to withhold income taxes from Federal employees to members of the National Guard and Ready Reserve when they are paid for performing regular training.

**Sec. 1206. Withholding tax on certain gambling winnings.**

The Committee replaced the information reporting requirement on certain gambling winnings with a provision for withholding on these winnings at a 20-percent withholding rate. The persons making the payment of winnings subject to withholding would be required to deduct and withhold from the payment 20 percent of the payment. For ease of compliance the withholding would be based on the entire payment rather than the amount of the winnings. The winnings subject to withholding would be the proceeds of \$1,000 or more from wagers in sweepstakes, wagering pools, or lotteries (whether or not conducted by a State or agency or instrumentality of a State). In the case of winnings other than those mentioned above, withholding would be required on payments of \$1,000 or more from the wagering transaction if the amount of the proceeds was at least 300 times as large as the amount wagered. The person who received the payment of winnings

subject to withholding would be required to furnish the payor with the name, address and taxpayer identification number of the person receiving the payment and of each person entitled to any portion of such payment, under penalty of perjury.

**Sec. 1207. Jeopardy and termination assessments.**

The Committee decided to provide for court review of jeopardy and termination assessments on an expedited basis. Under present law, the IRS may, under special jeopardy and termination assessment procedures, expedite the assessment and collection of taxes. A "jeopardy" assessment may be made if the IRS determines that the collection of any tax is in jeopardy after the end of a taxpayer's taxable period and after the passing of the due date for the return. A "termination" assessment may be made when the IRS determines that the collection of an income tax is in jeopardy prior to the expiration of a taxpayer's normal tax year (or prior to the date for the filing of the return). Presently, the taxpayer does not have the right of timely judicial review of all forms of jeopardy assessment or any form of termination assessment.

Under the Committee decision, if a jeopardy or termination assessment is made, the taxpayer will be able to promptly petition the United States Tax Court for judicial review. Within 20 days after the filing of a petition, the Tax Court is to determine whether the Service had reasonable cause for making the assessment and whether the amount of the assessment made was appropriate in view of all of the circumstances. In addition, until completion of judicial review, the Internal Revenue Service is not to sell property (other than perishables) seized pursuant to jeopardy or termination assessment procedures.

These rules are to apply to jeopardy assessments, termination assessments, and levies made after December 31, 1975.

**Sec. 1208. Minimum exemption from levy for wages, salary, and other income.**

The Committee also decided to exempt from levy, under jeopardy and termination assessment procedures and otherwise, a limited amount of a taxpayer's wages.

**Sec. 1209. Administrative summons.**

The Committee decided that in the case of a third-party summons (where the identity of the taxpayer is known), each summons is to include sufficient information to enable the third-party recordholder to locate the records pertaining to that taxpayer. The taxpayer is to receive notice of the summons from the IRS before its issuance. The taxpayer is to have standing to challenge the enforcement of the summons in a Federal court. However, notice to the taxpayer is not to be required in the case of an administrative summons to a bank, issued in connection with the Service's collection activities, solely for the purpose of ascertaining whether or not the taxpayer has an account in that bank.

In the case of the "John Doe" summons (where the identity of the taxpayer is not known), the IRS would have to go into court, establish the grounds for requesting the summons, and receive court approval before issuing the summons. In the case of a canvas of districts, pursuant to section 7601, no John Doe summons is to be issued, except in accordance with this court procedure.

### TITLE XIII—TECHNICAL INCOME TAX PROVISIONS

#### Sec. 1301. Tax treatment of certain cooperative housing associations.

The Committee agreed to provide that in the case of homeowner associations, condominium housing associations, and cooperative housing corporations, only the investment income and income derived from a trade or business is to be taxable. A deduction would be allowed for expenses directly attributable to any investment income and to any income derived from a trade or business. Assessments for the administration, maintenance and operation of the homeowners association, etc., would not be taxable.

To qualify for this treatment, 60 percent of the association's income for the taxable year must consist of amounts received as membership fees or assessments from members or shareholders.

These rules are to apply from the first of 1974.

#### Sec. 1302. Treatment of certain disaster payments.

Under present law (sec. 451(d)), insurance proceeds received by a taxpayer as a result of destruction or damage to crops may be included in income in the year following the year of their receipt, if he can establish that the income from the crops which were destroyed or damaged would otherwise have been properly included in income in the following year. This provision is intended to avoid the problem of doubling up of income for a cash basis farmer by including crop insurance proceeds in income in the year they were received rather than in the year following the year of receipt, which would generally be the pattern of income receipt from sales of crops.

Under the Agriculture and Consumer Protection Act of 1973, the Department of Agriculture makes specified payments to farmers in the event they are either prevented from planting certain crops because of drought, flood, or other natural disaster or condition or, because of such a disaster or condition, the total quantity of certain planted crops which the producers are able to harvest on any farm is less than 66 $\frac{2}{3}$  percent of the projected yield of the crop. Since premium payments are not required for this protection, the Internal Revenue Service has ruled that the proceeds are not insurance proceeds covered under the provision referred to above.

The committee agreed to include these disaster payments under section 451(d). As a result, cash basis farmers who receive payments under the Agriculture and Consumer Protection Act of 1973 for losses to crops caused by natural disasters, may elect to report the disaster proceeds as income in the year in which the income normally received from the crops would have been reported.

**TITLE XIV—TAX CREDIT FOR HOME GARDEN TOOLS**

**Sec. 1401. Tax credit for home garden tools.**

The committee agreed to provide a 7-percent investment tax credit to individuals for the purchase of home garden tools used in the production of home vegetable gardens. The credit is to be available on purchases of equipment up to \$100 a year (\$50 in the case of a husband or wife filing a separate return).

## TITLE XV—DEADWOOD

### Sec. 1501. Deadwood.

The committee agreed to the so-called "deadwood" provisions, which simplify the tax laws by removing from the Internal Revenue Code those provisions which are obsolete or no longer important and rarely used.

The provisions which have been developed over a number of years repeal almost 150 sections of the Internal Revenue Code and amend more than 850 other sections of the Code. The bill also makes other simplifying changes such as the substitution of the term "ordinary income" for phrases in the present law which obtain this result by referring to the income as "gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231."

The provisions deleted include those which deal only with past years, situations which were narrowly defined and are unlikely to recur, as well as provisions which have largely outlived their usefulness. In some situations, provisions have been added to preserve the right of persons to continue to receive benefits under code provisions which generally are repealed.

The deadwood provisions do not attempt to achieve simplification through substantive changes in existing law. Therefore, the provisions do not deal with policy issues or with substantive changes in generally applicable provisions.