[COMMITTEE PRINT]

DESCRIPTION OF TECHNICAL AND MINOR BILLS LISTED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON
MISCELLANEOUS REVENUE MEASURES

OF THE

COMMITTEE ON WAYS AND MEANS
ON SEPTEMBER 7 AND 9, 1977

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BY THE STAFF OF THE

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I. INTRODUCTION

The bills described in this pamphlet are those on which the Subcommittee on Miscellaneous Revenue Measures of the Committee on Ways and Means has announced a two-day public hearing for Wednesday, September 7, and Friday, September 9, 1977.

In connection with this hearing, the staff of the Joint Committee has prepared a description of the bills, similar to the descriptions the staff was directed to prepare in connection with the hearings on miscellaneous bills in the last Congress.[1]

The pamphlet first briefly summarizes the bills in consecutive bill number order. This is followed by a more detailed description of each bill indicating in each case the present law treatment, the issue involved, an explanation of what the bill would do, the effective date of the provision, the revenue effect of the provision, any prior congressional consideration of the bill, and the position of the Treasury Department or other relevant departments with respect to the bill.

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[1] The descriptions which the staff was directed to prepare in the last Congress were to indicate whether any of the bills were retroactive and to name any particular taxpayer to which a bill might be directed if the staff had such information.

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II. SUMMARY

1. H.R. 112—Messrs. Burleson of Texas, Armstrong, and Jones of Oklahoma

Tax Treatment of Private Foundations Operating Long-Term Care Facilities

Under present law, a 4-percent excise tax is imposed on the investment income of all private foundations. The bill would reduce the rate of this tax to 2 percent for any private operating foundation the principal activity of which is the operation of long-term care facilities.

2. H.R. 810—Mr. Conable

Treatment of Payment or Reimbursement by Private Foundations for Expenses of Foreign Travel by Government Officials

This bill would broaden an exception to the present rules prohibiting self-dealing between private foundations and disqualified persons. Under present law, the payment or reimbursement of expenses of Government officials by a private foundation generally is classified as a prohibited act of self-dealing. However, a limited exception to this rule permits a private foundation to pay or reimburse certain expenses of Government officials for travel solely within the United States. This bill would permit private foundations to pay or reimburse Government officials for expenses of foreign travel with certain limitations.

3. H.R. 1337—Mr. Steiger

Constructive Sale Price for Excise Tax On Certain Articles

The manufacturers excise taxes on trucks, buses, and related articles are based on the price at which the manufacturer sells a taxable product to a wholesale distributor. However, some manufacturers do not sell to wholesale distributors and statutory rules provide for constructive sale prices in these situations. In the case of a manufacturer selling only at retail, the Internal Revenue Service has developed constructive prices as a percentage of the manufacturer's retail selling price. The Service has also, however, promulgated a rule that in such cases of retail sales, if the manufacturer's actual costs in making the article exceed the percentage constructive price, the costs will instead be used as the base for computing the manufacturer's tax liability. The bill, while authorizing the continued use of percentage constructive sale prices in cases where an article is sold only at retail, would prohibit the use of costs as an alternative tax base for trucks, buses, and related articles (taxable under sec. 4061(a) of the Code).

4. H.R. 1920—Mr. Waggonner

Repayment of Alcohol Taxes and Duties After Loss Due to Disaster or Damage

The bill would extend the circumstances under which loss of distilled spirits, wines, rectified products, and beer held for sale after leaving the site of its production may generate a refund of the alcohol taxes and duties earlier paid on these products. At present, the only recognized cause is a presidentially-declared "major disaster." The bill would authorize refunds for losses resulting from fire, flood, casualty, or other disaster; or from breakage, destruction, or other damage (not including theft) resulting from vandalism or malicious mischief. However, no claim of less than $250 for any single occurrence or any claim for an insured loss would be allowable.

5. H.R. 2028—Mr. Conable

Excise Tax Treatment of Home Producers of Beer or Wine

H.R. 2028 would allow an individual 18 years of age or older who registers with the Treasury Department to produce wine and beer for personal and family use up to certain quantities without incurring the beer or wine tax or any penalties. The aggregate amounts which may be produced free of tax could not exceed 200 gallons of wine and 200 gallons of beer per year in a household in which there are two or more individuals 18 years or older. If there is only one individual 18 years or older in the household, the annual limit would be 100 gallons of wine and 100 gallons of beer. In addition, the bill would provide that the amount of such home-brewed beer on hand in any household at any one time (including beer in process) could not exceed 30 gallons.

6. H.R. 2714—Mr. Jones of Oklahoma

Employee Contributions to Pension, etc., Plans Used as Loan Security

The bill would amend both tax law and labor law to permit the use of participants' contributions to profit-sharing, stock bonus, or money purchase pension plans as collateral for a loan from a bank, building and loan association, or Federally-insured credit union.

7. H.R. 2852—Mr. Pickle

Exemptions From Aircraft Use and Fuel Excise Taxes for Aerial Crop Sprayers

An aircraft used primarily for agricultural (crop spraying) operations would be exempt from the annual aircraft use excise tax. In addition, present law allows a farmer to obtain credits or refunds for gasoline and special fuels excise taxes paid by an aerial crop sprayer on fuel used in agricultural operations for the farmer. The bill would allow the aerial crop sprayer to claim these credits or refunds if the farmer waives his rights to them.

8. H.R. 2984—Messrs. Duncan of Tennessee and Pickle

Exemptions From Excise Tax on Farm, Horse, or Livestock Trailers and Semitrailers

The bill would provide an exemption from the 10-percent manufacturers excise tax for trailers or semitrailers suitable for use with light-duty towing vehicles, but only if the trailer or semitrailer is designed to be used for farming purposes or for transporting horses or livestock. An exemption is also provided for a separately-sold body or chassis which is suitable for use with such a trailer or semitrailer.

9. H.R. 3050—Mr. Corman

Tax Treatment of Periodicals Sold for Display Purposes

The bill would provide that a publisher or distributor of periodicals who is on an accrual method of accounting may elect to exclude from income for the taxable year amounts attributable to sales of magazines or other periodicals for display purposes where the magazines or periodicals are returned within 3½ months after the close of the taxable year in which the sales were made. A sale would be treated as made for display purposes if the sale is made in order to permit an adequate display of the magazine or other periodical, and if at the time of the sale the taxpayer has a legal obligation to accept returns of the magazine or other periodical.

10. H.R. 3630—Mr. Andrews of North Dakota

Tax-Exempt Status of Mutual or Cooperative Telephone Companies

The bill would clarify the income-source requirement which must be satisfied by a mutual or cooperative telephone company as a condition for exemption from Federal income taxation. Present law provides that the cooperative can qualify for tax-exempt status only if at least 85 percent of its gross income consists of amounts collected from members to meet expenses. The Internal Revenue Service ruled, in 1974, that when the cooperative completes telephone calls to its members made by customers of another company under reciprocal call-completion arrangements, the cooperative receives payments which constitute nonmember income. The bill would provide, for post-1974 taxable years, that such payments are not to be counted in determining whether the cooperative satisfies the 85-percent member-income test.

11. H.R. 3633 (Title II)—Messrs. Breaux, Oberstar, Santini, Roe, Corrada, Price, Scheuer, Dent, Hubbard, Bowen, Forsythe, Leggett, Downey, Treen, Hawkins, Emery, Duncan of Tennessee, and Holland

Excise Tax on Ammunition Component Parts

Title II of H.R. 3633 would amend the Internal Revenue Code of 1954 to extend the present 11-percent manufacturers excise tax on firearms and prefabricated ammunition so as to apply to component parts of ammunition. This tax would apply to sales of cartridge cases, primers, percussion caps, bullets, shot, wads, and powders which are used by consumers to prepare their own ammunition. The existing law's from the 11-percent tax for sales to the Defense Department and certain other sales of prefabricated ammunition would also apply to sales of ammunition components.

12. H.R. 4030—Messrs. Guyer and Waggonner

Excess Business Holdings of a Private Foundation in a Public Utility

This bill would permit a private foundation and its "disqualified persons" together to hold 51 percent of the stock of a public utility, if certain requirements are met, by providing an exception to the excess business holdings rules of present law.

13. H.R. 4089—Messrs. Ullman, Frenzel, Roncalio, and Udall

Tax Treatment of Indian Tribes and Alaskan Native Villages

This bill would provide in general the same tax treatment with respect to recognized Indian tribes and Alaskan Native villages which now applies with respect to State and local governmental units. This series of provisions would treat recognized Indian tribes and Alaskan Native villages similarly to State and local governments for the purpose of determining whether the tribes and villages can issue tax-exempt municipal bonds and industrial development bonds, and the same as State and local governments for determining whether taxes paid to and charitable contributions made to the tribes and villages are deductible, and for certain other income and excise tax purposes.

14. H.R. 4458—Messrs. Rostenkowski and Waggonner

Distilled Spirits

The bill consists of a series of technical and administrative provisions which would—

(1) eliminate the requirement that the name of the distiller be placed upon gin or vodka bottled in bond for export;

(2) extend to distilled spirits that are imported and then packaged or bottled in the United States for export the same tax drawback benefits given to domestically produced spirits that are packaged or bottled for export;

(3) allow distilled spirits to be returned to bonded premises of distilled spirits plants or to export storage facilities, with benefit of tax credit or refund, etc., for storage pending exportation and certain other preferred dispositions (e.g., use on vessels and aircraft or for transfer to foreign-trade zones);

(4) allow spirits bottled in bond, or returned to an export storage facility for export, to be transferred without payment of tax to customs bonded warehouses for storage pending exportation;

(5) allow spirits to be withdrawn from bonded premises without payment of tax for purposes of research, development, or testing;

(6) relax the conditions under which bonded spirits may be mingled;

(7) allow gin to be made with the extracted oils of juniper berries and other aromatics, as well as with the juniper berries or other aromatics themselves, without payment of the rectification tax; and

(8) provide that these amendments take effect on the first day of the first calendar month which begins more than 90 days after the bill's enactment.

15. H.R. 5103—Messrs. Conable and Rostenkowski

Excise Tax Refunds in the Case of Tire Warranty Adjustments

The bill would provide a credit or refund of the manufacturers excise tax on tread rubber where the tread rubber is used in the recapping or retreading of a tire the sale price of which later is adjusted pursuant to a guarantee or warranty. The bill also would clarify the treatment of credits or refunds in the case of new or recapped tires the sale of which later is adjusted under a guarantee or warranty by providing that the credit be proportionate to the adjustment in price of the tire returned. Finally, the bill would extend the statute of limitations in the tire guarantee or warranty cases to allow a claim for tax credit or refund to be filed for at least one year after the adjustment with respect to the tire.

16. H.R. 6635—Mr. Pickle

Interest Rate Adjustments on Retirement Plan Savings Bonds

The bill would require semi-annual adjustments of the interest rate on outstanding U.S. individual retirement bonds so as to equate their yields with the current yield on Series E savings bonds.

17. H.R. 6853—Messrs. Jones of Oklahoma, Burleson of Texas, and Vander Jagt

Postponement of Time for Paying Excise Tax in the Case of Fishing Equipment

This bill would allow manufacturers, producers, and importers of fishing equipment and related accessories to postpone payment of the excise tax pertaining to the sale of any of these items until the close of the quarter immediately following the quarter in which the shipment was made.

18. H.R. 7003—Messrs. Bevill, Mann, Holland, and Flowers

Private Foundation Leasing of Business Assets To Disqualified Persons

The bill would permit, in certain circumstances, the indefinite continuation (or renewals) of a lease of property by a private foundation to a disqualified person if the lease was in existence on October 9, 1969. The bill would also extend through December 31, 1989, certain private foundation transitional rules which permit:

(1) the sale of stock by a private foundation to disqualified persons in certain circumstances, even though the private foundation is not obligated to dispose of that stock;

(2) the continuation of leases with disqualified persons if those leases were in effect on October 9, 1969; and

(3) the sale of leased property to disqualified persons if the property was subject to the transitional rule described in (2) above.

19. H.R. 8535—Mr. Conable

Child Care Credit for Amounts Paid to Certain Relatives

Under present law, the child care credit is allowed for amounts paid to relatives only if (1) neither the taxpayer nor the taxpayer's spouse is entitled to treat the relative as a dependent for whom a personal exemption deduction could be claimed, and (2) the relative's services constitute "employment" under the social security taxes definition. The bill would repeal the requirement that the services constitute "employment" under the social security taxes definition.

20. H.R. 8811—Messrs. Ullman and Conable

Revocability of Elections to Receive Tax Court Judge Retired Pay

The bill would allow an individual who has filed an election to receive retired pay as a Tax Court judge to revoke that election at any time before retired pay would begin to accrue, thereby enabling that individual to seek to qualify for benefits under the civil service retirement system.

21. H.R. 8857—Mr. Jacobs

Treatment of Sales of Corporate Assets in Connection With Certain Liquidations

Present law (sec. 337) provides that gain is not recognized to a corporation on the sale of property by it where, after it adopts a plan of liquidation, it completes its distributions within a 12-month period. This nonrecognition of gain is available to a corporation which would be a "collapsible corporation" but for the fact that it had held "purchased assets" for 3 years or more. The bill would extend the benefit of this provision to "collapsible corporations" which have held "constructed or produced" assets where the construction or production has been completed for 3 years or more. The bill also would provide that losses occurring in the 2-year period prior to the liquidation are to be offset against gains occurring in the liquidation period, to the extent that the losses are ordinary losses and arise out of transactions to which this provision (sec. 337) would apply. In addition, the bill would provide that in taxable years in which a 12-month liquidation occurs, the character of gains or losses from sales or exchanges of depreciable property used in a trade or business (sec. 1231) is to be determined without regard to the nonrecognition of gain or loss because of the liquidation.

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III. DESCRIPTION OF BILLS

1. H.R. 112—Messrs. Burleson of Texas, Armstrong, and Jones of Oklahoma

Tax Treatment of Private Foundations Operating Long-Term Care Facilities

Present law

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

In certain respects (generally involving a lesser minimum payout requirement and more favorable charitable contribution deduction rules), the Tax Reform Act of 1969 provided more favorable treatment for private operating foundations[2] than the treatment accorded to private foundations generally.

Issue

The issue is whether it is appropriate to reduce to 2 percent the rate of the tax imposed on the net investment income of private operating foundations that operate long-term care facilities; so that, with respect to these organizations, the tax more closely approximates an audit fee (or user charge) to cover the cost of the Internal Revenue Service's administration of the tax laws pertaining to exempt organizations.

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[1] A private foundation that is not exempt from tax under section 501(a) is taxed on the basis of the greater of (1) the income tax imposed on the foundation or (2) the 4-percent excise tax on investment income plus the unrelated business income tax (imposed under section 511).

[2] A private operating foundation is basically an organization which distributes substantially all of its income directly for the active conduct of exempt activities and which meets one of three other tests. Under the first test, substantially more than half of the assets of the foundation must be devoted directly to the activities for which it is organized or to functionally related businesses. Under the second test, the organization must normally spend an amount not less than two-thirds of the minimum investment return (i.e., two-thirds of 5 percent) to meet the current operating expenses of activities which constitute the purpose or function for which it is organized and operated. Under the third test, the organization must receive substantially all of its support from 5 or more exempt organizations and from the general public, and not more than 25 percent of the foundation's support may be received from any one exempt organization.

Explanation of the bill

Under the bill, the rate of the excise tax on the investment income of a domestic tax-exempt private foundation would be lowered to 2 percent if the foundation is an operating foundation which has as its principal activity the operation of a long-term care facility.[3] This bill would not affect the rate of the excise tax imposed on investment income of foreign private foundations (sec. 4948).[4]

Effective date

The bill would apply to taxable years beginning after September 30, 1977.

Revenue effect

The bill is estimated to result in an annual revenue loss of less than $1 million.

Prior Congressional action

A Senate amendment to the Tax Reform Act of 1976 would have reduced the investment income tax rate from 4 percent to 2 percent for all private foundations. That provision was not adopted in conference.

On September 27, 1976; the committee reported a bill (H.R. 11486; H. Rept. 94–1694) which would have reduced the investment income tax rate from 4 percent to 2 percent for any domestic tax-exempt private operating foundation the principal activity of which was operating an orphanage. H.R. 11486 (94th Cong.) was not acted upon by the House of Representatives because of lack of time before adjournment.

Departmental position

The Treasury Department opposes H.R. 112. The Department opposes special exceptions to the tax on investment income and suggests that if the 4-percent tax on investment income is to be reduced to 2 percent for private foundations that operate long-term care facilities, the tax should also be reduced to 2 percent for all private foundations. Treasury would not oppose H.R. 112 if this change were made.

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[3] This provision would not affect the amount of tax a non-exempt private foundation would pay.

[4] This bill is not intended to affect whether an organization (1) is described in section 501(c)(3), (2) is exempt under section 501(a), or (3) is classified as a "public charity", private foundation, or private operating foundation.

2. H.R. 810—Mr. Conable

Treatment of Payment or Reimbursement by Private Foundations for Expenses of Foreign Travel by Government Officials

Present law

The Tax Reform Act of 1969 added a provision to the Code (sec. 4941) which in general prohibits certain "self-dealing" acts between private foundations and certain designated classes of persons (commonly referred to as "disqualified persons") by imposing a graduated series of excise taxes on the self-dealer (and also on the foundation manager who willfully engages in acts of self-dealing). Under this provision, the payment or reimbursement of expenses of a government official by a private foundation generally is classified as an act of self-dealing.

A limited exception to this provision permits a private foundation to pay or reimburse certain expenses of government officials for travel solely within the United States. Under this exception, it is not an act of self-dealing for a private foundation to pay or reimburse a government official for actual transportation expenses, plus an amount of other traveling expenses not to exceed 125 percent of the maximum per diem allowed for like travel of employees of the United States for travel solely within the United States. However, no such payments or reimbursement is permissible for travel to or from a point outside the United States.

Issue

The issue is whether private foundations should be allowed to pay or reimburse government officials for expenses for foreign travel and, if so, under what circumstances.

Explanation of the bill

The bill would amend present law (sec. 4941(d)(2)(G) of the Internal Revenue Code) to provide an exception to the self-dealing provisions of the Code for payment or reimbursement of a limited amount of foreign travel expenses of a government official by a private foundation. The travel expenses which would be eligible to be reimbursed are for travel between a point in the United States and a point outside the United States. The amount which could be reimbursed for any one trip of a government official is (1) the lesser of (a) the actual cost of the transportation involved, or (b) $2,500, plus (2) an amount for all other traveling expenses not in excess of 125 percent of the maximum amount payable under section 5702(a) of title 5, United States Code (relating to like travel by U.S. employees) for a maximum of four days. Under section 5702(a), in the case of travel outside the continental United States, the President or his designee has the authority to establish the maximum per diem allowance for the locality where the travel is performed. Currently, for example, 125 percent of

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the daily amount so established for travel expenses is $72.50 for London, $87.50 for Paris, and $87.50 for Tokyo.

Under the bill, if more than half of a foundation's support (as defined in section 509(d)) is normally derived from any business enterprise, trade association, or labor organization, whether such support takes the form of interest, dividends, other income, grants, or contributions, that foundation's payments or reimbursements to government officials would not qualify for exception from self-dealing activities under this new provision. For purposes of determining whether a private foundation's support is normally derived from any business enterprise, trade association, or labor organization, "normal" support would be determined on the basis of a 4-year moving average.

Effective date

The bill would apply to travel beginning after the date of the bill's enactment.

Revenue effect

It is estimated that this bill will not have any direct revenue effect.

Prior Congressional action

The committee reported an identical bill (H.R. 2984; H. Rept. 94–1070) in 1976. H.R. 2984 (94th Cong.) was passed by the House of Representatives by voice vote on May 18, 1976, but it was not acted upon by the Senate Finance Committee or considered by the Senate.

Departmental position

The Treasury Department recommends that H.R. 810 be amended to limit (i) the permitted amount of reimbursable transportation expenses to the cost of the lowest coach or economy air fare charged by a commercial airline, and (ii) the permitted amount of all other reimbursable traveling expenses to the maximum per diem available for government trips to the same locations by Federal employees. The recommended change would make the reimbursable amounts under the bill consistent with the limitation on deductions for attending foreign conventions (sec. 274(h) of the Internal Revenue Code). With this change permitted reimbursable expenses for any one foreign trip by a government official would be the lowest coach or economy air fare charged at the time of travel, such amount not to exceed $2,500 or the actual cost of the transportation involved, plus an amount for all other traveling expenses not in excess of 100 percent of the per diem rates allowed Federal employees for government trips to the same locations for a maximum of four days. Treasury would not oppose H.R. 810 if these changes were made.

3. H.R. 1337—Mr. Steiger

Constructive Sale Price for Excise Tax On Certain Articles

Present law

A manufacturers excise tax of 10 percent is imposed under present law on the sale by a manufacturer or importer of trucks, buses, and highway tractors and related chassis, bodies, and trailers (sec. 4061 (a) of the Code).[1] This tax is based generally upon the price at which a taxable article is sold to a wholesale distributor in the ordinary course of trade.

The law also provides for determining a constructive sale price (on which the excise tax is based) when taxable articles are sold by manufacturers other than to wholesale distributors. In the case where a manufacturer sells a taxable article only at retail, the constructive sale price is to be the lower of either the price at which the article was sold, or the highest price at which competing articles are sold by other manufacturers to wholesale distributors (sec. 4216(b)(1)). The Treasury is authorized to determine the price at which competing articles are sold to wholesale distributors.

The Internal Revenue Service has ruled that where a manufacturer sells truck or truck trailer bodies only at retail, the price at which competing goods are sold to wholesale distributors is determined to be 75 percent of the price at which the manufacturer sold at retail.[2] The Service applies the 75-percent constructive price percentage in all cases where an article subject to tax under section 4061(a), including not only trailers and truck trailers but also the bodies and chassis of trucks and buses, is sold only at retail by a particular manufacturer.

The Service has also established a "cost floor" rule, which provides that where the manufacturer's actual costs of making and selling a taxable product are greater than the percentage constructive price, the actual costs are used as the tax base for excise tax purposes.[3]

Issue

The issue is whether the "cost floor" rule should be applied for purposes of determining a constructive sale price if a manufacturer sells trucks, buses, and similar articles only at retail.

Explanation of the bill

The bill would amend the constructive sale price rule to eliminate the use of the manufacturer's costs in determining the constructive sales price where trucks, buses, highway tractors, and related articles taxable under section 4061(a) are sold at retail by a particular

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[1] This tax is scheduled under present law to decline to 5 percent on October 1, 1979. Also, section 2026 of the National Energy Act (H.R. 8444), which passed the House on August 5, 1977, repeals the tax on buses as of April 20, 1977.

[2] Rev. Rul. 54-61, 1954-1 CB 259; Rev. Rul. 68-519, 1968-2 CB 513.

[3] *Ibid.* See Rev. Rul. 76-292, 1976—31 IRB II, for discussion of meaning of "cost".

manufacturer. The bill provides that the excise tax in these situations would be determined by using a percentage constructive sale price (the percentage to be determined by the Internal Revenue Service) based on the highest price for which such articles are sold by competing manufacturers in the ordinary course of trade.

Effective date

This bill would apply to articles which are sold by the manufacturer or producer after September 30, 1977.

Revenue effect

The revenue effect of this bill is indeterminate because it depends upon the new constructive sale price percentage set by the Service. However, the bill is estimated to result in an annual revenue loss or gain of less than $500,000.

Prior committee action

On September 28, 1976, the committee reported an identical bill (H.R. 11134; H. Rept. 94–1707). H.R. 11134 (94th Cong.) was not acted upon by the House of Representatives because of lack of time before adjournment.

Departmental position

The Treasury Department recommends that the provision of the bill which abolishes the "not less than cost rule" in the case of a sale at retail be amended so that it is made clear that the rule continues to be available for use in constructing a taxable price where a person makes and uses a taxable item (sec. 4218 of the Internal Revenue Code). Such an item may be a specialized unit which is never sold, so that no market price is available from which to construct a manufacturer's price. In this case, cost of production is the only realistic tax base. Treasury would not oppose H.R. 1337 if this change were made.

4. H.R. 1920—Mr. Waggonner

Repayment of Alcohol Taxes and Duties After Loss Due to Disaster or Damage

Present law

The excise taxes and customs duties on distilled spirits, wines, rectified products, and beer are paid or determined before these products leave the site of their production and enter marketing channels. If the products are subsequently lost, made unmarketable, or officially condemned while held for sale, the taxes and duties may be repaid by the Treasury only if the cause is a major disaster which is so declared by the President (sec. 5064 of the Code).[1] Similar repayment rules apply to tobacco products lost in major disasters so declared by the President (sec. 5708).

Issue

Whether repayment of alcohol excise taxes and duties should be allowed for losses resulting from vandalism or malicious mischief or from disasters of a lesser magnitude than those which are declared by the President to be "major disasters."

Explanation of the bill

The bill would provide for a repayment of the taxes and duties paid or determined on distilled spirits, wines, rectified products, and beer held for sale but lost or ruined because of certain causes. These causes are specified as fire, flood, casualty, or other disaster; or breakage, destruction, or other damage (not including theft) resulting from vandalism or malicious mischief. As a result, the causes of repayments by the Treasury of alcohol excise taxes and duties would be expanded beyond Presidentially-declared "major disasters" to include disasters of a lesser magnitude and intentional man-made damage. However, only uninsured losses would be allowed.

To prevent the imposition of an undue administrative burden upon the Treasury, no claim of less than $250 with respect to any single occurrence would be allowable. To avoid abuse, repayment would not be made in cases of claims of loss due to theft. In addition, all claims would have to be filed within six months of the date of the loss, and the claimant would have to furnish the Treasury with satisfactory proof

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[1] In general, section 5064 does not cover losses which take place at the site of production. Those losses are the subject of other sections of the Code. For example, in the instance of distilled spirits, section 5008 provides for abatement or refund of tax if distilled spirits are: (1) lost while in bond; (2) voluntarily destroyed while in bond; (3) voluntarily destroyed on bottling premises to which removed after payment or determination of tax; (4) lost (in a manner described in the law) after withdrawal from bond on payment or determination of tax and before removal from the bottling premises to which removed from bond; or (5) returned to the bonded premises of a distilled spirits plant for certain specified purposes after payment or determination of tax.

that there was no indemnification for the loss and that the claimant is also otherwise entitled to the payment.

This provision is intended to provide for a repayment of the high portion of the cost of alcoholic products that is attributable to prepaid taxes or duties when those products are lost. For example, the tax on the production of distilled spirits is, in general, $10.50 per gallon, the beer tax generally is $9 per barrel (equivalent to a tax of about 29 cents per gallon) and the wine tax ranges from 17 cents to $2.40 per wine gallon (depending upon the alcoholic content of the wine).

Effective date

The bill would apply to disasters (or other damage) occurring after September 30, 1977.

Revenue effect

The bill is estimated to result in an annual revenue loss of $500,000.

Prior committee action

On September 28, 1976, the committee reported a similar [2] bill (H.R. 1143; H. Rept. 94–1706). H.R. 1143 (94th Cong.) was not acted upon by the House of Representatives because of lack of time before adjournment.

Departmental position

The Treasury Department is opposed to H.R. 1920. The bill would in effect provide free fire, casualty, and flood insurance for merchants for the portion of their alcoholic beverage inventory attributable to excise tax and customs duty. Merchants holding other types of products do not receive similar protection against losses and there is no reason to provide such protection on a general basis. Furthermore, the bill would be difficult to administer since it would be difficult or impossible to make the required factual determination of the amount of loss by vandalism or malicious mischief, as distinguished from theft.

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[2] The 1976 bill would have retained subsections (c), (d), and (e) of section 5064. H.R. 1920, on the other hand, would appear to strike out those three subsections. It is not clear whether this difference from the 1976 bill is intended, especially since striking out these subsections would change existing law with respect to Presidentially-proclaimed disasters, not merely provide new rules with respect to fires, floods, etc.

Subsection (c) provides that repayments are not to be made under these provisions in the case of alcoholic products of Puerto Rican manufacture. Subsection (d) requires that where repayments have been made because the alcoholic products were condemned or made unmarketable, those products must be destroyed under Treasury supervision. Subsection (e) provides that repayments under these provisions are to be treated generally the same as refunds.

5. H.R. 2028—Mr. Conable

Excise Tax Treatment of Home Producers of Beer or Wine

Present law

Present law (sec. 5042 of the Code) permits the head of a family, after registering with the Treasury, to produce up to 200 gallons of wine a year for family use without payment of tax. However, a single individual who is not the head of a family is not covered by this exemption. (See Treas. Regs. 27 CFR § 240.540 *et seq.*)

The Bureau of Alcohol, Tobacco, and Firearms, interprets present law (sec. 5054(a)(3)) as providing that it is illegal to brew beer in one's home for home consumption. As a result, the tax of $9 per barrel (31 gallons or less), which is imposed on the production of beer (sec. 5051(a)), is due and payable immediately. In addition, the Bureau takes the position that the criminal penalties imposed by the Code (sec. 5687) on liquor tax offenses not otherwise specifically covered are applicable to the home brewer.

Issues

One issue is whether the present exemption from the wine tax for a head of a family who produces up to 200 gallons of wine a year for family use should be expanded to include individuals other than heads of families.

Another issue is whether there should be an exemption (similar to the exemption for home-produced wine) for beer which is produced by an individual in his or her home for personal use, rather than for commercial sale.

Explanation of the bill

The bill would modify the provisions of existing law that permit heads of households to produce wine tax-free for family use. Under the bill, the present limitations of 200 gallons of tax-free production in a calendar year would apply if there are two or more adults (age 18 or older) in the household who have registered with the Treasury Department for tax-free production. The present law's requirement that any such registered person be a "head of any family" would be repealed. The bill would also provide that, if there is only one adult in the household, then 100 gallons of wine may be produced tax-free in a calendar year.

The bill would provide essentially the same rule in the case of household production of beer, with the added requirement that the amount of beer on hand at any one time is not to exceed 30 gallons.

The bill also would make it clear that criminal penalties imposed under Federal law in connection with illegally produced beer do not apply to home production which qualifies for the exemption provided in this bill. There would also be a corresponding strengthening of the provisions dealing with illegally produced beer to make it clear that home production of beer that does not qualify for the new exemption is illegal.

Identical bill

H.R. 5898 (Mr. Seiberling) is identical to H.R. 2028.

Effective date

The bill would take effect October 1, 1977.

Revenue effect

The bill is estimated to result in an annual revenue loss of less than $1.5 million.

Prior committee action

On September 27, 1976, the committee reported an identical bill (H.R. 8643; H. Rept. 94–1692). H.R. 8643 (94th Cong.) was not acted upon by the House of Representatives because of lack of time before adjournment.

In the 93rd Congress, the committee included a similar provision in its unreported tax reform bill of 1974. In the 92nd Congress, the committee reported out a similar bill (H.R. 5372), but dealing only with wine (H. Rept. 92–784).

Departmental positions

The Treasury Department report on H.R. 2028 dated April 11, 1977, supports enactment of the bill but suggests that the requirement for registration by producers of wine for personal or family use be deleted. The Treasury Department maintains that registration has proven of little use to the Bureau of Alcohol, Tobacco, and Firearms and is burdensome to the public. However, for enforcement and revenue protection purposes, registration is necessary in the case of home brew, since the process entails the production of a mash fit for distillation, which bears a much higher tax.

The Department of Justice has not made known its views on H.R. 2028. However, that Department stated that, except for one minor reservation on its part, H.R. 8643 (94th Cong.) was unobjectionable to it. The committee thereafter amended H.R. 8643 (94th Cong.) in accordance with the Justice Department's recommendation.

6. H.R. 2714—Mr. Jones of Oklahoma

Employee Contributions to Pension, etc., Plans Used as Loan Security

Present law

Under present tax and labor law (title I of the Employee Retirement Income Security Act of 1974), an employee is not allowed to assign his vested benefits under a pension, profit-sharing, or stock bonus plan unless (A) the assignment is voluntary and revocable, does not exceed 10 percent of benefit payments being made, and is not for the purpose of defraying administrative expenses; or (B) the loan is made by the plan itself under a loan program available to all plan participants on a basis which does not provide greater amounts for employees who are officers, shareholders, or highly compensated, the interest rate is reasonable, and the security is adequate.

Issue

The issue is whether employees covered by money purchase pension plans (including "savings" or "thrift" plans), profit-sharing plans, or stock bonus plans should be permitted to use after-tax contributions they have made to the plans as collateral for loans from banks, building and loan associations, or Federally insured credit unions.

Explanation of the bill

The bill would amend both the tax law and the labor law to permit a certain amount under a profit-sharing, stock bonus, or money purchase pension plan to be used as collateral by the borrower for a loan from a bank, building and loan association, or Federally-insured credit union, without regard to the requirements of present law.

The amount which the bill would permit to be used as collateral is the lesser of (A) the participant's accrued benefit under the plan derived from his or her own contributions, or (B) the total amount of the participant's contributions to the plan reduced by withdrawals attributable to those contributions and other outstanding security interests in the participant's contributions to the plan. Under the bill, the terms of the loan must provide that the collateral from the plan will not at any time exceed this amount.

The amendment of the tax law contains a special provision relating to the deduction for interest payable on a loan secured by a participant's interest in a qualified plan, if the loan is used (directly or indirectly) for the purpose of financing a contribution to the plan by the participant. Subject to the usual rules, the interest payments on the loan would be deductible for the taxable year but only to the extent that there is a distribution from the plan which is includible in gross income in that year. If the amount of the interest for a taxable year exceeds the amount of any includible distribution in that year,

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the excess would be permitted to be carried over and deducted in a subsequent taxable year or years in which an includible distribution occurs (again, subject to the extent of the inclusion).

Effective date

The bill would apply to security interests created after the date of enactment.

Revenue effect

It is estimated that the bill will not have any direct revenue effect.

Prior committee action

On September 28, 1976, the committee reported an identical bill (H.R. 14717; H. Rept. 94–1709, Part 1). H.R. 14717 (94th Cong.) was not acted upon by the House of Representatives.

Departmental position

The Treasury Department opposes H.R. 2714. The bill would permit a participant to claim an immediate deduction for interest on the borrowed funds, while deferring payment of tax on the income earned by his contributions used as collateral for the loan until such income is distributed to him. The Treasury Department does not believe a taxpayer should be entitled to a current deduction for interest paid on amounts borrowed to purchase or carry investments the income from which is not taxed currently.

7. H.R. 2852—Mr. Pickle

Exemptions From Aircraft Use and Fuel Excise Taxes for Aerial Crop Sprayers

Present law

Aircraft use tax

Present law imposes an annual excise tax upon the use of civil aircraft (through June 30, 1980). This tax (under sec. 4491 of the Code) is based largely upon the weight of the aircraft.[1]

This annual use tax represents an "entry fee" to be paid each year (the use tax year is July 1 through June 30) that the aircraft flies in the navigable air space of the United States. The amount of the tax does not depend upon the number or length of the flights. If the aircraft is flown once during the month of July, for example, the entire year's tax must be paid. Lesser, prorated amounts are required to be paid if the first use occurs later in the year.

No exemptions from this excise tax are provided for farming use. As a result, no refund or credit of the aircraft use tax is allowed to either the farmer or a commercial crop sprayer where an aircraft is used for farming purposes.[2]

The revenues from this tax go to the Airport and Airway Trust Fund.

Fuel excise tax

Under present law (secs. 4041 and 4081) gasoline and special fuels used in noncommercial aviation, including use by commercial aerial crop sprayers, are subject to manufacturers (gasoline—4 cents) and retailers (gasoline—3 cents; special fuels—7 cents) excise taxes totalling 7 cents per gallon.[1] Exemptions from the gasoline and special fuels taxes are provided where the aircraft is used by commercial airlines, for farming, in foreign trade, by a State or local government, by a nonprofit educational organization, or by a qualified aircraft museum.

The exemptions for farming apply where the gasoline or special fuel is used by the owner, tenant, or operator of a farm in the United States to carry on the trade or business of farming. Where the taxes have been paid, the owner, tenant, or operator may obtain a "refund" of the excise taxes, either by a payment under the excise tax system (secs. 6420 and 6427) or by a refundable income tax credit (sec. 39). The repayment

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[1] The annual tax rate is $25, plus 2 cents per pound of maximum certificated takeoff weight over 2,500 pounds in the case of a nonturbine-powered aircraft, and 3½ cents per pound in the case of a turbine-powered aircraft.

[2] See Rev. Rul. 71–176, 1971–1 CB 379, where an illustration is given of the application of this tax to a 3,000-pound crop duster. The tax in that case would amount to $35 per year.

[1] Under schedules in present law, the manufacturers tax on gasoline is to drop by 2½ cents per gallon on and after July 1, 1979 (this is extended to July 1, 1985, by sec. 2024 of H.R. 8444, the Energy Tax Act of 1977, as passed by the House of Representatives); the retailers taxes on gasoline and special fuels for noncommercial aviation are to expire on July 1, 1980.

and credit provisions also apply where the gasoline or other fuel is used on the farm by someone (such as an aerial crop sprayer) other than the owner, tenant, or operator. In these situations, the owner, tenant, or operator reports the number of gallons of fuel consumed on (or over) the farm and claims the repayment or credit (see Treas. Regs. § 48.6420 (a)–1(c)).

The revenues from these taxes go to the Airport and Airway Trust Fund.

Issues

The bill presents two general issues, as follows:

(1) whether an exemption from the aircraft use tax should be provided for aircraft equipped for agricultural operation and used primarily for that purpose; and

(2) whether commercial aerial crop sprayers should obtain the benefit of the farming exemption from the excise taxes on gasoline and special fuels used on farms for farming purposes.

Explanation of the bill

The bill would provide an exemption from the annual use tax on civil aircraft in the case of aircraft equipped for agricultural operation under Federal Aviation Administration rules when the aircraft is used by an agricultural aircraft operator if that operator uses it primarily for agricultural operation.

The bill also would provide that an aerial crop sprayer would be entitled to a credit or refund of gasoline and special fuels excise taxes used in crop dusting on a farm. Although it is not specifically stated in the bill, it is understood that the bill is intended to allow a credit or refund to the aerial crop sprayer only if the farmer has waived any rights to that credit or refund.

Identical bills

The following bills are identical to H.R. 2852: H.R. 2957 (Mr. Alexander); H.R. 3765 (Mr. Natcher); H.R. 4142 (Mr. Mathis); H.R. 4411 (Mr. Burleson of Texas); H.R. 4834 (Mr. Holland); H.R. 4935 (Mr. Hammerschmidt), H.R. 5132 (Mr. Abdnor); H.R. 5272 (Mr. Tucker); and H.R. 5597 (Messrs. Pickle and Steed).

Effective date

The bill would take effect as of July 1, 1977.

Revenue effect

The bill is estimated to result in an annual revenue loss of $1 million.

Prior Congressional action

In 1964 the Ways and Means Committee reported legislation similar to the language in this bill dealing with credits or refunds of fuels taxes. The 1964 bill (H.R. 7267; H. Rept. 88–1336) was approved by the House of Representatives but no action was taken in the Senate.

Departmental position

The Treasury Department opposes the provision of this bill that would exempt agricultural aircraft from the annual use tax. Nearly all noncommercial aircraft operators claim that they make small use of the Federal airways system. But noncommercial operators already pay very little toward the cost of the airways system that the FAA says is allocable to their operations.

The Treasury Department supports the provision of the bill that would permit aerial crop sprayers to receive credits or refunds of the fuels taxes if the farmers otherwise eligible for those credits or refunds have waived in writing their rights in favor of those aerial crop sprayers.

8. H.R. 2984—Messrs. Duncan of Tennessee and Pickle

Exemptions From Excise Tax on Farm, Horse, or Livestock Trailers and Semitrailers

Present law

Present law (sec. 4061(a)(1) of the Code) imposes a 10-percent excise tax [1] on bodies and chassis of trucks and truck trailers and semitrailers sold [2] by the manufacturer, producer, or importer. An exclusion from the tax is provided (sec. 4061(a)(2)) for sales of bodies and chassis of "light-duty" trucks, buses, and truck trailers and semitrailers.[3] To qualify for this exclusion, the truck trailer and semitrailer chassis and bodies must be suitable for use with a trailer or semitrailer having a gross vehicle weight (GVW) of 10,000 pounds or less (determined according to Treasury Department regulations).[4] In addition, the truck trailer or semitrailer itself must be suitable for use with a towing vehicle with a GVW of 10,000 pounds or less.

The revenues from this tax go to the Highway Trust Fund.

Issue

Present law excludes from the manufacturers excise tax "light-duty" trailers and semitrailers suitable for use with "light-duty" trucks. The issue is whether the light-duty limitation on the trailer or semitrailer exclusion should be removed in the case of trailers or semitrailers designed to be used for farming purposes or for transporting horses or livestock.

Explanation of the bill

The bill would provide an exemption from the manufacturers excise tax in the case of certain sales of any trailer, semitrailer, or body or chassis for a trailer or semitrailer which is suitable for use with a towing vehicle with a GVW of 10,000 pounds or less. The trailer or semitrailer involved would no longer itself have to have a GVW of 10,000 pounds or less. To qualify for this exemption, however, the trailer or semitrailer (with a GVW of more than 10,000 pounds) must be designed for use for farming purposes or for transporting horses or livestock.

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[1] The tax rate is scheduled to be reduced to 5 percent for sales on or after October 1, 1979.

[2] The statute provides that the sale of an entire trailer, semitrailer, or truck shall be considered a sale of the chassis and of the body of the trailer, etc.

[3] Sales of automobiles and automobile trailers and semitrailers were excluded from the then 7-percent excise tax by the Revenue Act of 1971 (Public Law 92–178). Since many persons use smaller trucks as passenger cars, sales of light-duty trucks and their trailers and semi-trailers were also excluded from the 10-percent truck excise tax by that Act.

[4] "Gross vehicle weight" means the maximum total weight of a loaded vehicle. Treasury Regs. § 48.4061(a)–1(f)(3).

To avoid creating competitive disadvantages because of the relative sizes of dealers' inventories, and in conformity with prior excise tax repeal practice, the bill would provide for floor stocks refunds with respect to all articles exempted by the bill that are still in dealers' inventories on the day after the bill's enactment.

Effective date

The exemptions proposed by the bill would apply with respect to articles sold on or after the date of enactment.

Revenue effect

The bill is estimated to result in an annual revenue loss of less than $2 million.

Prior Congressional action

The committee reported an identical bill (H.R. 6521; H. Rept. 94-1349) in 1976. H.R. 6521 (94tth Cong.) was passed by the House of Representatives by voice vote on August 24, 1976, but it was not acted upon by the Senate Finance Committee or considered by the Senate.

Departmental position

The Treasury Department opposes the bill because the bill would discriminate against single-unit trucks (*i.e.*, without trailers or semitrailers) and nonfarm trailers and semitrailers of the same carrying capacity.

9. H.R. 3050—Mr. Corman

Tax Treatment of Periodicals Sold for Display Purposes

Present law

Generally, taxpayers using the accrual method of accounting for income must include sales in income for the taxable year when all the events have occurred which fix the right to receive the income and the amount can be determined with reasonable accuracy. Generally, the method used by the taxpayer in determining when income is to be accounted for is acceptable by the Internal Revenue Service if it accords with generally accepted accounting principles consistently used by the taxpayer from year to year. For example, the income tax regulations (Treas. Regs. § 1.446–1(c)(1)) provide that a taxpayer engaged in a manufacturing business may account for sales of the product when the goods are shipped, when the goods are delivered or accepted, or when title to the goods passes to the customer (whether or not billed) depending upon the accounting method regularly employed in keeping books. When sold goods are returned to a taxpayer during a taxable year the return generally is treated as a reduction of gross sales for purposes of financial and tax accounting.

Tax accounting differs from financial accounting in that tax accounting generally does not permit deductions for estimates of future costs. Thus, tax accounting does not permit an offset in the year in which the sale is made for the return of periodicals in the following year.

Issue

Magazine and other periodical publishers and distributors often distribute to retail outlets more copies of a periodical than it is anticipated the retailer can sell. The extra copies are distributed to assure the retailers an adequate number of copies for display purposes. When the next issue of the periodical is published and shipped to the retailer, the earlier issue is treated as being "off-sale" and the retailer returns the unsold copies of the periodical to the publisher.

Many publishers have for a number of years accounted for their returns of periodicals on a net basis (by calculating the estimated returns) at the time of shipment. The Internal Revenue Service has taken the position [1] that accrual basis publishers and distributors must include the sales of the periodical in income when the periodicals are shipped to the retailers and may exclude from income returns of the periodicals only when the copies are returned by the retailer during the

[1] The Service's position has been upheld in the courts with respect to magazines (*Scott Krauss News Agency, Inc. v. Comm'r*, T.C. Memo 1964–71), books (*Readers' Publishing Corp. v. U.S.*, 40 F.2d 145 (Ct. Cl., 1930); and *J. J. Little and Ives Co., Inc., v. Comm'r. T.C. Memo* 1966–68), and records (*Ahmet Ertegun v. Comm'r*, 531 F.2d 1156 (CA 2, 1976)).

taxable year. The argument is made that when the sale and the return of the magazine occur in two separate taxable years, this method tends to create a distortion of income for Federal tax purposes.

The issue is whether, when periodicals are shipped to retailers for display purposes with no expectation on the part of the parties that these periodicals will be sold, it is appropriate to treat the shipments as income to the publisher or distributor.

Explanation of the bill

The bill would provide that, in the case of sales of magazines or other periodicals for display purposes, an accrual method taxpayer may elect to exclude from gross income for the taxable year in which the magazines or other periodicals are shipped the income attributable to the sale of any magazine or other periodical which is returned not later than the fifteenth day of the third month after the close of the taxpayer's taxable year (i.e., the date on which the corporate tax return generally is due). The election would apply only to taxpayers using an accrual method of accounting for the trade or business for which the election is made. As an alternative to the physical return of the periodicals to the publisher, the taxpayer may establish, under procedures which would be provided by regulations, that the periodical has not been sold and will not be sold. For example, it is customary under some circumstances not to return the entire magazine but merely to cut off the front cover and return that portion of the magazine to the publisher or distributor and sell the balance as scrap.[1]

A sale would be for display purposes under this provision if the sale is made in order to permit an adequate display of the magazine or other periodical and if at the time of sale the taxpayer has a legal obligation to accept returns of the magazine or other periodical.

These provisions would apply to sales for display purposes but only if the taxpayer makes an election under this provision with respect to the trade or business in connection with which the sales are made. An election under this provision could be made only with respect to taxable years beginning after December 31, 1975, and only with the consent of the Internal Revenue Service under Treasury regulations.

An election of this provision would apply to all sales of magazines and other periodicals made for display purposes in connection with the trade or business with respect to which the taxpayer has made the election. However, the election would not apply to sales made for display purposes before the first taxable year for which the election is made. Once an election is made, it would be effective for the taxable year with respect to which it is made and for all subsequent taxable years unless the Service consents to the revocation of the election. The computation of taxable income under an election under this provision would be treated as a method of accounting. Thus, the provisions of the Code relating to adjustments required by changes in method of

[1] In cases where the periodical is not returned, it is sometimes the practice to contribute the periodical to a charitable organization for the organization's own use or for sale in a thrift shop. In cases where the periodical is contributed rather than sold to a charitable organization, the bill contemplates that documentation of this fact would be an acceptable method of substantiating that the periodical has not been sold. In these cases, however, charitable contribution deductions are not allowed under present law and that result would not be changed by this bill.

accounting (sec. 481) would apply to the making and the revocation of the election, and any adjustments may be spread over a 10-year period.

Effective date

The bill would apply to taxable years beginning after December 31, 1975.

Revenue effect

The bill as a "change in the method of accounting" is estimated to result in a revenue loss of $1 million the year after enactment, and less than $2 million for subsequent years.

Prior Congressional action

The committee reported an identical bill (H.R. 5161; H. Rept. 94–1354) in 1976. H.R. 5161 (94th Cong.) was passed by the House of Representatives by voice vote on August 2, 1976, but it was not acted upon by the Senate Finance Committee or considered by the Senate.

In the 93rd Congress, the committee included an identical provision in its unreported tax reform bill of 1974.

Departmental position

The Treasury Department recommends that the following changes be made to the bill. First, in order to be equitable to taxpayers who are similarly situated, the Treasury recommends that the bill be extended to cover two additional industries which experience significant returns, the paperback book industry and the sound recording industry. Second, the Treasury believes that the special relief provided by the bill should be allowed only to taxpayers who reasonably anticipate substantial returns of goods after year end (*e.g.*, 20 percent) which were sold during the prior taxable year. Finally, Treasury proposes that taxpayers electing the new method of accounting be required to establish a suspense account to delay the deduction for goods returned during the year the election is made, but before the due date (without extensions of time) for filing the income tax return for the prior year. Requiring a suspense account would prevent a revenue loss of $50 million in the year of enactment. This loss would result from a deduction during that year for returned items sold in the prior year as well as returned items sold in the year of enactment.

The Treasury Department supports this bill if the above changes are made.

10. H.R. 3630—Mr. Andrews of North Dakota

Tax-Exempt Status of Mutual or Cooperative Telephone Companies

Present law

Under present law (sec. 501(c)(12) of the Code), a mutual or cooperative telephone company qualifies for exemption from Federal income taxation only if at least 85 percent of its gross income, computed on a yearly accounting period, consists of "amounts collected from members for the sole purpose of meeting losses and expenses." In Rev. Rul. 74-362, 1974-2 CB 170, the Internal Revenue Service took the position that amounts earned by a telephone cooperative in connection with completing calls made to its members by subscribers to another telephone company constitute nonmember income. Accordingly, if it cannot be established that such amounts are less than 15 percent of total receipts, the telephone cooperative cannot qualify for exempt status.

Issue

The issue is whether gross amounts actually or constructively received or accrued from a nonmember telephone company, in connection with the servicing of calls to or from a telephone cooperative's members, should be counted for purposes of the 85-percent income-source requirement in determining the income tax status of a telephone cooperative.

Explanation of the bill

The bill would provide that amounts or credits received by a mutual or cooperative telephone company from another company for communication service on a call involving a member of the cooperative are not to enter into the 85-percent member-income test in determining the telephone cooperative's income tax status.

Identical bills

The following bills are identical to H.R. 3630: H.R. 7098 (Mr. Oberstar); and H.R. 7605 (Messrs. Andrews of North Dakota, AuCoin, Carter, Findley, Holland, Johnson of Colorado, Marlenee, Neal, Poage, Rose, Simon, Whitten, and Robinson).

Effective date

The bill would apply to taxable years beginning after December 31, 1974.

Revenue effect

The revenue effect of this bill is indeterminate because the tax-exempt status of cooperative telephone companies is dependent upon the Service's income source regulations in applying the 85% member-income test. However, it is estimated that the maximum revenue impact would be either a gain or a loss of no greater than 2 million dollars.

Prior committee action

In the 93d Congress, the committee included an identical provision as section 534 of its unreported tax reform bill of 1974.

Departmental position

The Treasury Department supports the general principle of the bill that the receipt of amounts from a nonmember telephone company, in connection with the servicing of calls to or from a telephone cooperative's members, should not jeopardize the exempt status of the telephone cooperative. However, the Treasury Department recommends that this result be accomplished by amending H.R. 3630 (i) to eliminate the requirement of present law that 85 percent of the income of the cooperative be derived from its members, (ii) to treat all income integrally related to the exempt function of the cooperative, such as amounts received from a nonmember telephone company in connection with servicing calls to or from the cooperative's members, as exempt from tax, and (iii) to tax the cooperative on all unrelated business income, including passive investment income. These changes would treat telephone cooperatives and other entities exempt under section 501(c)(12) in the same manner as entities exempt under section 501(c)(7) (social clubs) are treated under present law.

11. H.R. 3633 (Title II)—Messrs. Breaux, Oberstar, Santini, Roe, Corrada, Price, Scheuer, Dent, Hubbard, Bowen, Forsythe, Leggett, Downey, Treen, Hawkins, Emery, Duncan of Tennessee, and Holland

Excise Tax on Ammunition Component Parts

Present law

Under present law, excise taxes are imposed on sales by manufacturers and importers of certain types of recreational equipment and supplies. A 10-percent tax is imposed on pistols and revolvers and an 11-percent tax is imposed on other types of firearms and upon prefabricated shells and cartridges used in firearms (sec. 4181 of the Code). In addition, there is imposed an 11-percent tax upon certain archery equipment and supplies (sec. 4161(b)). Exemptions from the firearms and ammunition taxes are provided for items sold to the Department of Defense and for sales of certain firearms which have been taxed under section 5811 of the Code (relating to transfer taxes on firearms). Additional exemptions to all of the above taxes are provided for sales to State and local governments and in certain other cases.

Amounts equivalent to the receipts from the excise taxes on firearms, prefabricated ammunition, and archery equipment and supplies are transferred to the Wildlife Restoration Fund (16 U.S.C. 669b), from which appropriations are authorized to the States (on a sharing basis) for use in carrying out wildlife restoration projects (generally to acquire and maintain wildlife habitats), hunter safety programs, and the construction and operation of public target ranges. This fund is administered by the Department of Interior.

Issue

The issue under title II of the bill is whether the 11-percent excise tax on prefabricated shells and cartridges should be extended to ammunition components.

Explanation of title II of the bill

An 11-percent manufacturers excise tax would be imposed by this title on the sale of component ammunition parts by the manufacturer or importer. This tax would apply to sales of cartridge cases, primers, percussion caps, bullets, shot, wads, and powders which are used by consumers to load or reload their own ammunition for firearms (including pistols and revolvers). The application of this tax would be limited to these specified component parts and it would not apply to other expendable items (such as flints for a flintlock firearm) which might otherwise be considered to be used in the propulsion process of a firearm and be broadly construed to be an ammunition component. The tax would, however, extend not only to components which are assembled (into cartridges or shells) before insertion into the firearm, but also to components which are loaded separately into the firearm, such as powder, wads, etc., used in loading a muzzleloading weapon.

The existing exemptions for sales of prefabricated ammunition to the Department of Defense would be extended by this title to apply to sales of ammunition components (sec. 4182(b)). Existing general exemptions from manufacturers taxes for (1) further manufacture, (2) export, (3) supplies for vessels or aircraft, (4) State or local governments, and (5) exempt educational institutions would automatically apply to this tax on ammunition components (sec. 4221).

Effective date

The tax imposed under this title would apply to ammunition components sold by manufacturers or importers on or after October 1, 1977.

Revenue effect

The bill is estimated to result in an annual increase of excise tax revenues of $5 million. Amounts equal to revenues collected would be transferred to the Wildlife Restoration Fund.

Prior Congressional action

The committee favorably reported an identical provision, except for the effective date (title II of H.R. 9067; H. Rept. 94–1459, pp. 19–23, and 33), in 1976. H.R. 9067 (94th Cong.) was not acted upon by the House of Representatives before adjournment.

Departmental position

The Treasury Department opposes the general principle of "earmarking" revenues. However, if it is considered important to be consistent and apply the existing excise tax on shells and cartridges to ammunition components, the Treasury Department would not oppose H.R. 3633. Also, the effective date should be postponed, to give sufficient notice to people who will be liable for this tax.

12. H.R. 4030—Messrs. Guyer and Waggonner

Excess Business Holdings of a Private Foundation in a Public Utility

Present law

The Tax Reform Act of 1969 imposed an excise tax upon the excess business holdings of a private foundation (sec. 9443 of the Code). Generally, under the excess businses holdings provisions, the combined ownership of a business by a private foundation and all disqualified persons cannot exceed 20 percent of the voting stock of the business (35 percent if other persons have effective control of the business).

The 1969 Act provided that, if a private foundation and disqualified persons together had holdings on May 26, 1969, in excess of the permitted amounts under the general rules, then those holdings could be retained if they consisted of not more than 50 percent of the business. If the combined holdings exceeded 50 percent of the business on that date, then over a transitional period the combined holdings have to be reduced to 50 percent (ultimately to 35 percent if the disqualified persons hold, in the aggregate, no more than 2 percent of the business; if they hold more than 2 percent, then the combined holdings may continue to be as much as 50 percent, of which the foundation itself may hold no more than 25 percent). In one case under the 1969 Act rules, a foundation and its disqualified persons together are permitted to continue to hold 51 percent of a business.

Issue

The issue is whether a private foundation and its disqualified persons together should be permitted to continue to hold a 51-percent interest in a public utility where the public utility is regulated, is relatively small, is not directly managed by disqualified persons, distributes to its shareholders at least 40 percent of its aftertax earnings, and meets certain other requirements.

Explanation of the bill

The bill would provide an exception to the tax on excess business holdings of a private foundation in the case of certain stock of a public utility. Where the foundation and the public utility meet certain tests under the bill, the foundation and its disqualified persons together would be permitted to hold up to 51 percent of the voting stock of the public utility.

In order to qualify for the special exception for public utility stock, the following tests would have to be met:

(1) the private foundation must have held on May 26, 1969, at least 50 percent of the voting stock of the public utility (for this purpose, stock held in a trust or decedent's estate created before May 27, 1969, is deemed held by the private foundation if the

foundation is the primary or remainder beneficiary of the trust or estate);

(2) all of the public utility stock owned by the private foundation must have been acquired by gift, devise, or bequest;

(3) no officer, director, or trustee of the public utility can be a person who contributed stock to the private foundation or a member of the family of any person who gave, devised, or bequeathed any public utility stock to the foundation;

(4) the utility must have been a public utility on May 26, 1969;

(5) the utility's taxable income for the first taxable year ending after May 26, 1969, must have been less than $1,000,000;

(6) the utility must have distributed to its shareholders, in each of any 3 of the 5 years preceding the year of enactment and each year ending after the date of enactment, at least 40 percent of its net income (determined after Federal, State, and local taxes for that year); and

(7) the private foundation does not purchase any interest in the public utility after the date of enactment.

This bill is intended to apply to the holdings of the Hauss-Helms Foundation in the Telephone Service Company of Wapakoneta, Ohio.

Effective date

The bill would apply to taxable years ending after the date of enactment.

Revenue effect

It is estimated that this bill will not have any direct revenue effect.

Departmental position

The Treasury Department opposes this bill. The Treasury Department is opposed to creating special exceptions to the excess business holdings provisions on an *ad hoc* basis. Regardless of the nature of the business controlled by the foundation and its donor or donors, the mere existence of foundation control inevitably tends to direct the foundation's efforts to operating the business more profitably and thus to divert attention from the charitable purposes of the foundation.

13. H.R. 4089—Messrs. Ullman, Frenzel, Roncalio, and Udall

Tax Treatment of Indian Tribes and Alaskan Native Villages

Present law

The Internal Revenue Code does not specifically exempt Indian tribes from taxation; however, the Internal Revenue Service has ruled that "Income tax statutes do not tax Indian tribes. The tribe is not a taxable entity." (Rev. Rul. 67–284, 1967–2 CB 55, 58.) The ruling provides further that "tribal income not otherwise exempt from Federal income tax is includable in the gross income of the Indian tribal member when distributed or constructively received by him." The income of individual Indians is generally taxable; however, income to a tribe or individual Indian derived from allotment lands is not taxable.

Issue

The issue is whether Indian tribes and Alaskan Native villages which meet certain criteria should be treated substantially the same as State and local government for most Internal Revenue Code purposes.

Explanation of the bill

The bill would accord to recognized Indian tribes the tax treatment now available to governmental units. The term "recognized Indian tribe" would include any tribe, band, community, village, or group of Indians or Alaska Natives which is recognized by the Secretary of the Treasury, after consultation with the Secretary of the Interior, as performing substantial governmental functions. This definition would be intended to provide tax treatment as governmental units to the same Indian tribes and Alaskan Native villages which are treated as governmental units for certain revenue sharing purposes under the State and Local Fiscal Assistance Act of 1972. As of July 1977, 327 Indian groups were listed as eligible for revenue sharing entitlements under that Act.

In particular, the bill would provide beneficial tax treatment with respect to: retirement income derived from employment by such a tribe; contributions made to those seeking election to a tribal office; interest paid on bonds issued by tribes (including industrial development bonds); scholarships and fellowship grants made by tribes; taxes imposed by tribes on real property and on income; charitable contributions to tribes; contributions by tribes for employee annuities; estate and gift tax charitable contributions to tribes; retailers and manufacturers excise taxes; and communications excise tax as they relate to tribes. In addition, the bill would provide for repayments by the Treasury Department with respect to gasoline used on farms of such tribes, gasoline used for certain nonhighway purposes or by local transit systems of such tribes, lubricating oil not used in highway motor vehicles of such tribes, and fuels not used for taxable purposes by such tribes.

Also, the bill would treat the tribes' colleges and universities as governmental schools for purposes of the unrelated business income tax, and would provide that certain tribal officials are to be "government officials" for purposes of the tax on self-dealing between a private foundation and a disqualified person.

A major effect of the bill would be to permit recognized Indian tribes to issue debt obligations the interest on which is exempt from income taxation. However, tax-exempt treatment would not be available for interest on any obligation (other than an industrial development bond) issued by a recognized Indian tribe if all or a major portion of the proceeds are to be used directly or indirectly in any commercial or industrial activity. In the case of industrial development bonds, the exemption would apply only if (1) the principal activities of the trade or business financed with the proceeds of the bonds are carried on in the area reserved by Federal statute, Executive order, or treaty to the Indian tribe issuing the bonds and (2) substantially all of the activities of the trade or business which are carried on outside of the reservation area are purchasing, marketing, or similar activities directly related to the activities carried out within the reservation area.

Effective dates

The provisions of the bill relating to income tax deductions or credits would apply to taxable years beginning after September 30, 1977. The provisions relating to estate taxes would apply to estates of decedents dying after that date, and those relating to gift taxes would apply to gifts made after that date. The provisions relating to excise taxes would take effect on October 1, 1977.

Revenue effect

It is estimated that the section of the bill providing for the deductibility of tribal taxes would reduce income tax revenues by $1 million a year. The revenue effects of other provisions in the bill cannot be estimated with confidence; however, it is estimated that all provisions of the bill will reduce overall tax liability by less than $5 million a year.

Prior committee action

On September 27, 1976, the committee reported an identical bill (H.R. 8989; H. Rept. 94–1693). H.R. 8989 (94th Cong.) was not acted upon by the House of Representatives because of lack of time before adjournment.

Departmental position

The Treasury Department recommends that the term "Indian Tribe" be substituted where the term "recognized Indian Tribe" appears in the bill. The term "recognized" has many connotations in Federal Indian policy associated with the provision of services by the Department of the Interior. It would be misleading and inappropriate to create a new designation of "recognized" tribes under the auspices of the Secretary of the Treasury when alternative wording is possible. The Treasury Department would not oppose H.R. 4089 if these changes were made.

14. H.R. 4458—Messrs. Rostenkowski and Waggonner

Distilled Spirits

The bill consists of a series of technical and administrative provisions. The following is a description of each of the sections of the bill.

(1) *Identification of distiller—gin and vodka*

Present law.—Under present law (sec. 5233(c) of the Code), no trademarks may be placed upon bottles of distilled spirits bottled in bond unless the name of the distiller or of the company in whose name the spirits are produced and warehoused also appears "conspicuously" on the bottle. This requirement extends to gin and vodka as well as to other forms of distilled spirits.

Issue.—Gin and vodka are produced from neutral spirits produced by grain processing plants. These neutral spirits are then purchased by the companies that process the gin and vodka itself. Since the ultimate manufacturers or processors of the gin or vodka are not the distillers or producers, they are foreclosed from placing their own trademarks on the bottles unless the names of the grain processing plants are also placed conspicuously on the bottles. Most gin and vodka bottled in bond is exported. The issue presented by the bill is whether it is so important that the foreign customer of the gin and vodka be shown, conspicuously, the name of the grain processing plant that produced the basic neutral spirits.

Explanation of the provision.—The bill would exclude gin and vodka bottled in bond for export from the requirement that, if the bottle is to carry a trademark, the name of the actual distiller or of the individual or company in whose name the spirits were produced and warehoused must also be on the bottle.

(2) *Drawback of tax on exported spirits and wines previously imported*

Present law.—Under present law, a drawback equal to the amount of the tax determined or paid on wines or distilled spirits that are exported is allowed if the wines or distilled spirits were manufactured or produced in the United States. (If the tax has been determined but not yet paid, the drawback takes the form of a book credit. If the tax determined has been paid, the drawback results in a repayment of the tax.)

If the operator of a customs manufacturing bonded warehouse reduces the proof of imported distilled spirits and bottles or packages them, he may then export those spirits and obtain a drawback on the U.S. tax (sec. 5523). However, if a domestic proprietor of a distilled spirits plant imports distilled spirits and conducts the same operations and then exports them, he is not entitled to a drawback of the U.S. tax.

Similar distinctions operate in the case of wines.

Issue.—Whether it is appropriate to permit drawbacks of tax for exported spirits which (1) were domestically produced or (2) were first imported and then processed in a customs warehouse (as at present) but not to permit such drawbacks of tax where the exported spirits were first imported and then processed in a domestic distilled spirits plant.

Explanation of the provision.—The bill would enable distilled spirits or wines "bottled, or packaged in casks or other bulk containers" in the United States (after their import) to be exported with the benefit of drawback of the tax determined or paid on those distilled spirits or wines. The same benefit would continue to be extended to distilled spirits or wines manufactured or produced in the United States and subsequently exported. The same technical requirements regarding claims for drawback, stamps, notices, bonds, bills of lading, and other evidence indicating payment or determination of tax and exportation would be applicable to distilled spirits and wines bottled or packaged in the United States as are applicable to goods manufactured or produced in the United States.

(3) *Return of tax-determined distilled spirits to bonded premises*

Present law.—Present law (sec. 5215) allows distilled spirits (other than products to which any alcoholic ingredients other than tax-determined distilled spirits have been added) withdrawn from bond on payment or determination of tax to be returned to bonded premises for destruction, denaturing, redistilling, or mingling. For these cases, present law (sec. 5008(d)) allows the abatement, remittance, credit, or refund of the tax that has been paid or determined. All provisions of law applicable to distilled spirits in bond are also applicable to these distilled spirits returned to bond.

However, no return to bonded premises, with abatement, remittance, credit, or refund of the tax, is allowed for the purpose of storage. In fact, present law (sec. 5612) specifically forbids spirits on which the tax has been paid or determined to be stored in bonded premises, except for certain designated purposes which do not include storage pending exportation.

In addition, present law (sec. 5178(a)(4)(A)(ii)) allows distilled spirits to be treated as "bottled in bond" although they are actually bottled on bottling premises located outside bonded premises. Tax liability on those spirits is incurred when they are withdrawn from bond for bottling on the bottling premises.

In the case of such spirits actually bottled outside of bonded premises and then returned to bonded premises for storage pending exportation, as well as in the instance of spirits withdrawn from bond for storage pending exportation, a drawback of the tax is allowed when the spirits are actually exported (sec. 5062(b)). In the meantime, however, the working capital of the distilled spirits exporter has been tied up in tax payments or liabilities for spirits in storage pending exportation.

Issue.—Whether tax-determined distilled spirits ought to be returnable to bonded premises (with benefit of a tax credit or refund) in the plant where they were bottled or packaged if the return is for exportation or other purposes listed in sections 5214(a) and 7510; and whether spirits that can be treated as bottled in bond although actually bottled outside of bond ought to be transferable (with tax credit or refund) to bonded premises for storage pending withdrawal for any purpose for which spirits actually bottled in bond may be stored.

Explanation of the provision.—The bill would permit tax-paid (or tax-determined) distilled spirits to be returned (with tax credit or refund) to an export storage facility in the bonded premises of the plant where they were bottled or packaged if the spirits are thus returned or transferred solely for storage pending withdrawal without payment of tax for the following purposes: exportation (under specified provisions of section 5214(a)(4)); as supplies for certain vessels or aircraft; for transfer to foreign-trade zones; for transfer (for storage pending exportation) to a customs bonded warehouse; or free of tax for use of the United States under section 7510 of the Code. In addition, the bill provides that spirits which may be treated as bottled in bond although actually bottled outside of bonded premises may be returned to the bonded premises of the same plant (with benefit of the tax credit or refund) for storage pending withdrawal for any purpose for which spirits that have in fact been bottled in bond may be withdrawn.

(4) Withdrawal for transfer to customs bonded warehouse

Present law.—Under present law (sec. 5214(a)(4)), distilled spirits may be withdrawn without payment of tax from the bonded premises of distilled spirits plants for exportation, but there is no comparable provision allowing withdrawal without payment of tax for transfer to customs bonded warehouses for storage pending exportation.

Issue.—Whether distilled spirits should be allowed to be withdrawn, without payment of tax, from bonded premises for transfer to customs bonded warehouses for storage pending exportation.

Explanation of the provision.—The bill would permit distilled spirits bottled in bond (under sec. 5233) or spirits returned to an export storage facility on the bonded premises where they were bottled or packaged for storage pending exportation, etc., under the proposed new section 5215(b) (see the explanation of sec. 3 of the bill, *supra*) to be transferred without payment of tax to a customs bonded warehouse for storage pending exportation. The spirits so transferred would be entered, stored, and accounted for under such regulations and bonds, to protect the revenue, as the Secretary may prescribe.

(5) Withdrawal for scientific purposes

Present law.—Present law (sec. 5214(a)(9)) permits distilled spirits to be withdrawn from the bonded premises of a distilled spirits plant free of tax for use as samples in making tests or laboratory analyses.

Issue.—Whether, and with what safeguards, distilled spirits should be able to be withdrawn from bonded premises for use in research, development, or testing (other than consumer testing) where tax has not been paid or determined.

Explanation of the provision.—The bill would permit distilled spirits to be withdrawn without payment of tax by a proprietor of bonded premises for use in research, development, or testing (other than consumer testing or other market analysis) of processes, systems, materials, or equipment relating to distilled spirits or distillery operations.

The withdrawals would be subject to such limitations and conditions as to quantities, use, and accountability as the Secretary may by regulations require for the protection of the revenue.

Because of the change of the nature of withdrawals under the provision from withdrawals "free of tax" to withdrawals "without payment of tax," the tax may be reimposed in the case of abuses or certain losses prior to the permitted uses for which the spirits were withdrawn.

(6) *Mingling and blending*

Present law.—Under present law (sec. 5234(a)(2)), distilled spirits mingled on bonded premises must be returned to the same packages (barrels) from which removed, and the mingling must be for the purpose of further storage in bond.

Issue.—Whether the requirements relating to mingling and blending—that the mingled spirits be returned to the same barrels from which they were removed, and that the mingling be for the purpose of further storage in bond—should be eliminated as restrictions serving no significant tax or regulatory purpose and to permit greater flexibility in plant operations.

Explanation of the provision.—The bill would eliminate the clause in section 5234(a)(2) of the Code requiring that mingling on bonded premises be "for further storage in bond in as many as necessary of the same packages in which the spirits were stored before consolidation."

(7) *Use of extracted oils of juniper berries and other aromatics in making gin*

Present law.—Present law (sec. 5025(b)) allows an exemption from the rectification tax (in general, this is a tax on redistilling, purifying, or refining distilled spirits, or mixing to achieve a different product) for the production of gin by redistillation of a pure spirit over juniper berries and other natural aromatics. This exemption is, therefore, confined to gins produced by the use of juniper berries or other natural aromatics themselves, and does not extend to use of their natural oils.

Issue.—Whether extracted oils of juniper berries and of other natural aromatics may be used in redistillation of gin.

Explanation of the provision.—The bill would permit an exemption from the rectification tax in the instance of gin produced by the redistillation of a pure spirit over the extracted oil of juniper berries and other natural aromatics.

Identical bill

H.R. 8772 (Mr. Snyder) is identical to H.R. 4458.

Effective date

The amendments made by the bill would take effect on the first day of the first calendar month which begins more than 90 days after the bill's enactment.

Revenue effect

It is estimated that sections 3 and 4 of the bill would result in a one-time revenue loss of $3 to $5 million because persons withdrawing distilled spirits from bonded premises for bottling or packaging and subsequent return to an export storage facility on the bonded premises, and persons withdrawing spirits from bonded premises for transfer to a customs bonded warehouse for storage pending exportation, would no longer have their payments of tax on the distilled spirits tied up until evidence of export is received and the drawback claim is allowed.

The remaining changes proposed by the bill would have little revenue effect.

Prior Congressional action

The committee reported a similar bill (H.R. 3055; H. Rept. 94-1200) in 1976. The bill was passed by the House of Representatives by voice vote on June 8, 1976. H.R. 3055 (94th Cong.) was reported, with amendments, by the Senate Finance Committee (S. Rept. 94-1347) on September 29, 1976, but was not acted upon by the Senate because of lack of time before adjournment.

H.R. 4458 is identical to H.R. 3055 (94th Congress) as passed by the House, except for changes necessary to conform the bill to the Internal Revenue Code as amended by the Tax Reform Act of 1976.

Departmental position

The Treasury Department has no objection to the bill. In a report to the committee on July 25, 1977, the Treasury Department recommended that the first section of the bill be extended so as to delete the requirement of identification of the distiller in all cases, not merely as to gin and vodka, and whether or not the spirits are bottled for export. Present law does not require the name of the actual distiller to be shown on the label of distilled spirits not bottled in bond. Such a requirement for spirits bottled in bond serves to provide a marketing advantage to those bottlers of bottled in bond products who do their own distilling.

15. H.R. 5103—Messrs. Conable and Rostenkowski

Excise Tax Refunds in the Case of Tire Warranty Adjustments

Present law

Present law (sec. 4071 of the Code) imposes a tax of 5 cents per pound on tread rubber used for retreading tires of a type used on highway vehicles, and a tax of 10 cents per pound on new tires of the type used on highway vehicles.[1]

In the case of new tires, credit or refund is available where the sales price later is adjusted under a guarantee or warranty. However, no credit or refund of the tread rubber tax is provided if the sales price of a retreaded tire is adjusted pursuant to a guarantee or warranty (sec. 6416(b)(2)(G)).

The credit or refund for new tire guarantee or warranty adjustments is computed by reference to the proportion of any replacement tire's sale price, rather than that of the original tire, which is credited or refunded by the manufacturer to the customer (sec. 6416(b)(1); Rev. Rul. 59–394, 1959–2 CB 280). This proportionate method of adjustment may result in a smaller credit or refund to the extent that the replacement tire is more expensive than the original tire. Where the manufacturer does not allow a per tire credit or refund for defective tires, but instead either adjusts the overall sales price of tires purchased by a dealer or wholesaler, or computes the refund or credit on an estimated or average basis, no credit or refund of the tax is allowed to the manufacturer since the manufacturer has not made an adjustment on the individual tire that was adjusted for guarantee or warranty.

Claims for a tax credit or refund must be filed by the later of three years from the time the tax is due, or two years from the time the tax is paid. No credit or refund can be obtained if a guarantee or warranty adjustment is made after the statute of limitations has expired.

Issues

The bill raises several issues. First, whether a tax credit or refund of the manufacturers excise tax on tread rubber used in the recapping or retreading of a tire should be available where the sale price of a tire is adjusted pursuant to a guarantee or warranty. Second, whether any tax credits or refunds available due to the adjustment of the sales price of a tire under a guarantee or warranty should be based on the price of the original tire, rather than on the price of the replacement tire, and should be available even though a taxpayer other than the original customer receives the adjustment, or the adjustment is made on other than a per tire basis. Third, whether the statute of limitations for filing refund claims should be extended.

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[1] The tax is scheduled to expire for tread rubber, and to be reduced to 5 cents per pound for new tires, on October 1, 1979 (sec. 4071(d)).

Explanation of the bill

The bill would make a credit or refund of the tread rubber tax available where the tread rubber is used in the recapping or retreading of a tire if the sales price later is adjusted because of a guarantee or warranty.

The bill would amend the law so that when a warranty or guarantee adjustment is made on account of a tire, the amount of the deemed overpayment of tire tax is to be the amount that bears the same proportion to the total tax paid on the tire, as the price adjustment made to the holder of the warranty or guarantee bears to the total price of a replacement tire. However, in no event would the deemed overpayment be greater than the amount of the tax credit or refund paid by the manufacturer to (or passed on to) the ultimate vendor (unless the manufacturer obtains the ultimate vendor's written consent to the obtaining of the refund or credit, sec. 6416(a) (1) (C)).

This approach would be used regardless of whether the consumer has returned the tire to the same retailer from which it was purchased, so long as the adjustment is made pursuant to a warranty for guarantee and the manufacturer ultimately passes on the tax overpayment to the person who made the adjustment with the consumer. This approach also would apply whether the adjustment is made by an allowance against the price of a replacement tire or by cash refund. The same approach also would apply in determining the amount of tread rubber tax that is treated as an overpayment.

This same approach would be applied whether the adjustment is made by a retailer to a consumer, or by a manufacturer to a retailer in cases where the manufacturer's warranty is held by the retailer rather than by the ultimate consumer.

In the latter case, the credit or refund would be based on the adjustment in any replacement tire given by the manufacturer to the retailer (rather than on any adjustment given to the ultimate consumer).

The above-described rule would apply most clearly when the manufacturer makes an adjustment on a tire-by-tire basis. Under the bill, these rules would apply also where the manufacturer makes the adjustment (either to ultimate consumers or to retailers which hold the manufacturer's warranty) on a sampling or averaging basis.

The bill also would modify the statute of limitations in cases where a claim for credit or refund is filed as a result of a warranty or guarantee adjustment. The bill would provide that in such a case a claim for credit or refund may be filed at any time before the date which is one year after the date on which the adjustment is made, if otherwise the period for filing the claim would expire before that later date.

Effective date

The bill would take effect on October 1, 1977.

Revenue effect

It is estimated that the bill would result in a negligible revenue loss.

Prior Congressional action

The committee reported a bill with similar provisions (H.R. 2474; H. Rept. 94–1334) in 1976. H.R. 2474 (94th Cong.) was passed by the House of Representatives by voice vote on August 24, 1976. The bill was reported by the Senate Finance Committee (S. Rept. 94–1348) on

September 29, 1976, but was not acted upon by the Senate because of lack of time before adjournment.

H.R. 5103 is identical to those portions of H.R. 2474 (94th Cong.) as reported by the Senate Finance Committee, that dealt with tires and omits substantially all the portions of H.R. 2474 (94th Cong.) that dealt with tread rubber.

Departmental position

The Treasury Department does not believe a refund or credit of excise tax should be allowed where the manufacturer merely reduces his initial selling price to reflect anticipated warranty expenses which his vendee may incur. The Treasury Department recommends that lines 9 through 25 on page 2 of the bill be clarified to assure that a refund or credit will not be allowed where the manufacturer in substance has merely reduced his initial selling price. With this modification the Treasury Department does not object to the bill.

The Treasury Department notes that the predecessor of this bill, H.R. 2474 (94th Cong.), contained provisions dealing with tread rubber. The Treasury Department would not object if the tread rubber provisions were added to this bill.

16. H.R. 6635—Mr. Pickle

Interest Rate Adjustments on Retirement Plan Savings Bonds

Present law

Individuals may deduct payments made to purchase individual retirement bonds issued for this purpose by the Treasury Department. (These bonds, which are not transferable, are subject to many of the restrictions that apply to individual retirement accounts.) Similar bonds are issued for retirement and annuity plans established by employers for their employees. The interest rate on each of these U.S. individual retirement bonds remains unchanged throughout the period it is outstanding.

The interest rates on outstanding Series E savings bonds which are available for purchase by the general public are increased whenever there is a change in the interest rates on new issues of Series E bonds.

Issue

Interest rates on outstanding Series E bonds are increased whenever the yield on new issues is increased in recognition of the bondholder's ability to redeem the outstanding bond before maturity for the principal and accrued interest and to reinvest the proceeds in new Series E bonds issued with the higher interest rate. Individual retirement bonds retain the interest rate unchanged from the time of issue until redemption, some time after the taxpayer reaches the age of 59½ years. Retirement plan bonds are like bonds issued by private corporations (in which an individual retirement account may invest some of its corpus) in that the interest rate on a corporate bond generally remains unchanged from time of issue until maturity. If interest rates rise, the trustee of an individual retirement account which holds a marketable corporate bond may sell it in order to take advantage of the higher yield on new issues, but the account probably would suffer a capital loss, as the market adjusts the prices of bonds to equalize the yields on issues with comparable risk.

The issue is whether the interest rate on U.S. individual retirement plan bonds should be increased semiannually to equality with the interest rate on Series E U.S. savings bonds.

Explanation of the bill

The bill would require that the interest rate on U.S. individual retirement plan bonds be increased for each semiannual interest accrual period so that the investment yield on the bonds is consistent with the current investment yield on Series E savings bonds.

Effective date

The bill would apply to interest accrual periods that begin after September 30, 1976.

Revenue effect

It is estimated that this bill will have no effect on budget receipts.

Prior committee action

On September 28, 1976, the committee reported an identical bill (H.R. 13649; H. Rept. 94–1710). H.R. 13649 (94th Cong.) was not acted upon by the House of Representatives because of lack of time before adjournment.

Departmental position

The Treasury Department supports this bill. It will help to assure that the rate of return to holders of retirement bonds is maintained at a level commensurate with the rate of return on Series E savings bonds.

17. H.R. 6853—Messrs. Jones of Oklahoma, Burleson of Texas, and Vander Jagt

Postponement of Time for Paying Excise Tax in the Case of Fishing Equipment

Present law

Treasury Department regulations (§ 48.6302(c)-1) prescribe the time for making deposits of manufacturers excise taxes. The regulations provide that if the liability for all taxes reportable on IRS form 720 exceeds $2,000 for any month in the preceding calendar quarter, the manufacturer is required to pay such taxes on a semimonthly basis within 9 days after the close of the period involved.

Issue

Retail sale of sport fishing equipment is seasonal in nature. However, manufacturers of such equipment produce year round to make efficient use of capital and labor. In order to avoid inventory storage costs, manufacturers encourage wholesalers and retailers to make early purchases of fishing equipment stock by offering extended credit terms. The manufacturers excise tax on fishing equipment is payable relatively soon after the fishing equipment is sold by the manufacturer, regardless of the fact that the deferred credit terms may result in sale proceeds not being collected for several months.

The issue is whether the payment of excise taxes imposed upon the sale of fishing equipment should be postponed for up to five months and one week in order to more closely match the collection of sale proceeds and payment of the tax.

Explanation of the bill

The bill would provide that the excise tax on the sale of fishing equipment would be payable at the close of the quarter immediately following the quarter in which the shipment was made.

Effective date

The bill would apply to sales occurring on or after October 1, 1977.

Revenue effect

It is estimated that enactment of this provision will reduce collections by $8 million during the year after enactment, and about $1 million for the subsequent years.

Prior committee action

A similar bill (H.R. 11006, 94th Cong.) was considered by the Committee on Ways and Means on March 3, 1976, and was disapproved by a vote of 14 to 7.

Departmental position

The Treasury Department opposes this bill. Vendors of different products extend credit for varying periods determined by their own business needs and customer relations. The time for collection of Federal taxes should not depend on such vendor decisions. Moreover, vendors must finance their production costs as well as taxes, and it is not apparent why prompt payment of taxes imposes any greater burden than prompt payment of the cost of supplies and labor.

18. H.R. 7003—Messrs. Bevill, Mann, Holland, and Flowers

Private Foundation Leasing of Business Assets to Disqualified Persons

Present law

Under present law (sec. 4941 of the Code), private foundations are generally prohibited from engaging in transactions with disqualified persons. The prohibited acts (referred to as acts of "self-dealing") include the "sale or exchange, or leasing, of property between a private foundation and a disqualified person". A "disqualified person" is defined to include anyone who is a "substantial contributor" to the foundation. A "substantial contributor" includes any person who has contributed more than $5,000 to the foundation, if the total contributions from the person exceed 2 percent of the total contributions received by the foundation. A person who becomes a substantial contributor retains that status forever.

These provisions were added by the Tax Reform Act of 1969. In order to permit the orderly termination of arrangements existing in 1969 between private foundations and their disqualified persons, the 1969 Act (sec. 101(l)(2)(C) of the Act) permitted then-existing leasing arrangements to continue for up to 10 years (through 1979), but only so long as the foundation was not disadvantaged by the terms of the lease. In addition, the Tax Reform Act of 1976 amended the 1969 Act to allow these permitted transitional leases to be terminated by a sale of the leased property by the foundation to disqualified persons. This provision (sec. 101(l)(2)(F) of the 1969 Act) required that any such sale must be completed before January 1, 1978.

Another provision of present law (sec. 4943) limits the percentage of ownership which a foundation and its disqualified persons together can hold in any single business. In general, the combined business ownership of a foundation and disqualified persons in any business may not exceed 20 percent, but 35 percent ownership by the foundation and disqualified persons together is permitted where an unrelated group is shown to be in control of the business. These provisions were also added by the Tax Reform Act of 1969, and include transitional rules to allow foundations an adequate opportunity to dispose of their then-existing holdings. Under these transitional rules, where a foundation itself owned more than 95 percent of the voting stock in a business in 1969, an initial transitional period of 20 years (generally through May 26, 1989) was provided for the foundation to reduce its combined ownership (together with disqualified persons) to 50 percent. Where lesser percentages were owned in 1969, transitional periods of 10 and 15 years were provided. The Act also allowed foundations to dispose of their excess holdings by sales to disqualified persons (sec. 101(l)(2)(B) of the 1969 Act).

In summary, the Congress—

(1) provided restrictions on foundation involvement in acquisition of businesses and forbade completely any new leasing relationships with disqualified persons,

(2) provided transitional periods for disposing of existing "excess business holdings" and terminating continuing relationships with disqualified persons, and

(3) permitted self-dealing sales only if they would facilitate the disposition of excess business holdings or the termination of continuing lease relationships.

Issues

The bill presents several related issues:

First, whether there should be a permanent "grandfather clause" for certain cases permitting indefinite continuation of a lease of property by a private foundation to disqualified persons.

Second, whether the present law's 10-year period for terminating leases in existence in 1969 should be extended an additional 10 years (through 1989).

Third, whether a private foundation should be permitted to sell such leased property to a disqualified person at any time through the end of 1989.

Explanation of the bill

The bill would permit, in certain circumstances, the indefinite continuation (or renewals) of a lease of property by a private foundation to a disqualified person if the lease was in existence on October 9, 1969. This would be permitted only if the following conditions are met: (1) the lessor is a corporation whose stock is wholly owned by the private foundations; (2) the lease did not violate the limited restrictions on self-dealing in effect prior to the Tax Reform Act of 1969; (3) the terms of the lease are at least as favorable to the private foundation's wholly owned subsidiary as a lease entered into in an arm's length transaction would be; (4) the private foundation's subsidiary corporation is not itself exempt from income tax; and (5) the disqualified person (the lessee) became a disqualified person solely because of contributions made to the private foundation before October 9, 1969.

The bill would extend through December 31, 1989, a special transitional rule (which expired on December 31, 1976) permitting the sale of stock by a private foundation to disqualified persons even though the private foundation would not be obliged to dispose of that stock.

The bill would extend through December 31, 1989, the present transitional rule (now scheduled to expire on December 31, 1979) permitting the continuation of leases with disqualified persons if those leases were in effect on October 9, 1969.

The bill would extend through December 31, 1989, the existing transitional rule (currently scheduled to expire on December 31, 1977) permitting the sale of leased property that was subject to the transitional rule described in the preceding paragraph.

The intended beneficiaries [1] of the bill are: Public Welfare Founda-

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[1] The first provision in the bill, permitting an indefinite continuation of certain leases, appears to be drafted so as to apply only to the situation presented by the intended beneficiaries listed above. The second provision does not appear to be related to that situation. The remaining two provisions apply across-the-board, and so would affect all private foundations with "grandfather clause" leases.

tion, Inc., a private foundation organized by Charles E. Marsh; the taxable, wholly-owned subsidiaries of Public Welfare Foundation, Inc. (The Spartanburg Herald and Journal, Inc., The Gadsden Times, Inc., and The Tuscaloosa News, Inc.); and three newspaper operators (Newspaper Management-Production, Inc., Gadsden Times Publishing Corporation, and Tuscaloosa Newspapers, Inc.) which lease the assets owned by Public Welfare Foundation, Inc.'s wholly-owned subsidiaries.

The principal owners of the three operating companies are, respectively, Phil Buchheit, Frank Halderman, Sr., and James B. Boone, Jr. The newspapers operate in South Carolina and Alabama.

Effective date

The bill would take effect upon enactment.

Revenue effect

It is estimated that the bill will not have any direct revenue effect.

Prior Congressional action

On August 4, 1977, the Senate Finance Committee considered the text of S. 1514 (identical to H.R. 7003), amended the text, and ordered that the amended text be reported as an amendment to H.R. 2849. The Senate Finance Committee amendment would provide, in effect, that the three newspaper operators would not be treated as substantial contributors for purposes of the self-dealing rules.

Departmental position

The Treasury Department recommends that the bill be amended to provide, in effect, that the three newspaper operators not be treated as substantial contributors for purposes of the self-dealing rules. The Treasury Department would not oppose the bill as so amended.

19. H.R. 8535—Mr. Conable

Child Care Credit for Amounts Paid to Certain Relatives

Present law

A taxpayer who incurs expenses for household and dependent care services in order to enable the taxpayer to work is entitled to a nonrefundable 20-percent tax credit for the care of a child under the age of 15 or for an incapacitated dependent or spouse, with an annual credit limit of $400 for one dependent and $800 for two or more dependents (sec. 44A of the Code).

Under the prior law deduction for child care expenses, no deduction was allowed for amounts paid to relatives. The Tax Reform Act of 1976 replaced the deduction with a credit and expanded the availability of the provision. Under present law, no credit is allowed for amounts paid to a relative unless (1) neither the taxpayer nor the taxpayer's spouse is entitled to treat the relative as a dependent for whom a personal exemption deduction could be claimed, and (2) the services provided by the relative constitute "employment" within the meaning of the social security taxes definition.

The social security taxes definition of employment (sec. 3121(b)(3)(B)) excludes domestic services provided by the taxpayer's parent in the taxpayer's home [1] by the taxpayer's parent unless the taxpayer is a surviving spouse or a divorced individual and has not remarried or has a mentally or physically incapacitated spouse unable to care for a child living in the home.[2] Thus, except in these circumstances, child care services provided by the child's grandparent in the taxpayer's home are exempt from social security taxes and ineligible for the child care credit.

Services performed by other relatives of the taxpayer or the taxpayer's spouse (except a child under age 21) are not specifically excluded from the section 3121(b) definition of employment and may constitute qualified services if a bona fide employer-employee relationship exists.

Issue

The issue is whether a child care credit should be allowed for payments to relatives in cases where the services rendered by the relatives are not subject to social security taxes.

Explanation of the bill

The bill would delete the provision that amounts paid for child

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[1] Services provided by the taxpayer's parent in the taxpayer's parent's home do, however, constitute employment under section 3121(b), if a bona fide employer-employee relationship exists. Such services are eligible for the section 44A credit.

[2] In order for any services to constitute employment within the meaning of section 3121(b), an employer-employee relationship must exist.

care services performed by relatives must be for services which constitute employment within the meaning of section 3121(b) in order to qualify for the credit.[3]

The bill would not change the requirement of present law that the credit is not available for amounts paid to a relative if either the taxpayer or the taxpayer's spouse is entitled to a dependency personal exemption deduction with respect to that relative.

Identical bills

H.R. 8733 (Messrs. Conable, Fisher, Frenzel, Lederer, and Ketchum, and Ms. Keys) is identical to H.R. 8535.

Effective date

The amendment proposed by the bill would apply to taxable years beginning after December 31, 1976.

Revenue effect

The bill is estimated to result in a decrease in budget receipts of $10 million in fiscal year 1978, $11 million in fiscal year 1979, $11 million in fiscal year 1980, etc.

Departmental position

The Treasury Department opposes the bill. Present law is inconsistent in permitting the child care credit for payments to relatives in certain circumstances and not in others. To eliminate this inconsistency, the Treasury Department recommends disallowing the credit for amounts paid to relatives in all cases. The Treasury Department believes the potential abuses of permitting the child care credit for amounts paid to a relative of the taxpayer, including the splitting of income through gifts to relatives who are in lower income tax brackets or have income below taxable levels, outweigh the merits of granting the credit for such payments.

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[3] Section 3121(b) excludes from the definition of employment any services provided by a child under age 21 for his or her father or mother. This bill would allow a credit for such services but only if the child is not a dependent of the parent.

20. H.R. 8811—Messrs. Ullman and Conable

Revocability of Elections to Receive Tax Court Judge Retired Pay

Present law

If a United States Tax Court judge elects to come under the Tax Court retirement system, all civil service retirement benefits are waived. In other words, any Tax Court judge who elects to be covered by the Tax Court retirement system may not receive any benefits under the civil service retirement system for any service performed before or after the election is made, for services performed as a judge or otherwise.

A Tax Court judge must retire at age 70, but may retire at age 65 after having served as a judge at least 15 years. A judge may retire at a younger age with 15 years of service if he or she is available for reappointment at the conclusion of a term but is not reappointed. A judge who is permanently disabled must retire. Generally, retirement under any of these conditions is at full pay under the Tax Court retirement system.

If a judge reaches the mandatory retirement age of 70 prior to having served 10 years, the Tax Court pension is based on the number of years served. If a judge is retired because of disability, but has not served 10 years, the Tax Court pension is one-half the salary of the office.

The Tax Court retirement system is noncontributory. That is, the judges are not required to make contributions toward their own retirement. The Tax Court survivors' benefit provisions, however, require that the judges make contributions (3 percent of salary) if they want coverage for their families. The civil service retirement system is contributory (generally, 7 percent of salary). The civil service system includes survivor benefits with no additional contributions required for those benefits. If a judge elects to come under the Tax Court retirement system, then not only is that judge excluded from civil service retirement benefits, but also the judge's survivors are excluded from the civil service survivors' progam, whether or not the judge also elects to come under the Tax Court survivors' program.

Present law has been interpreted as barring an individual who elects to be covered by the Tax Court judges retirement system from ever receiving any civil service benefits, even though the minimum requirement of 10 years of Tax Court service necessary to qualify for Tax Court judge retired pay never may be met, and notwithstanding the fact that the individual otherwise might qualify for civil service retirement benefits. Thus, an individual who has creditable civil service time prior to and after Tax Court service, and who elected Tax Court retirement pay while a judge, but served in that capacity for less than 10 years, will be precluded from receiving benefits under either system. Similarly, an individual who had creditable civil service time prior to serving as a Tax Court judge will be barred from receiving any retirement benefits if a Tax Court election was made but he failed to serve on the Court for the number of years necessary to be entitled to Tax Court retirement pay.[1]

Issue

The issue is whether an election to come under the Tax Court retirement system should be allowed to be revoked before retired pay begins to accrue, thereby allowing the individual to qualify to receive civil service retirement benefits.

Explanation of the bill

The bill would allow an individual who has filed an election to receive retired pay as a Tax Court judge to revoke that election at any time before the first day on which retired pay would begin to accrue with respect to that individual.

The bill also would provide that no civil service retirement credit would be allowed for any service as a Tax Court judge, unless with respect to such service the amount required by the civil service retirement laws has been deposited, with interest, in the Civil Service Retirement and Disability Fund.

Under the bill, a revocation of an election to come under the Tax Court retirement system also constitutes a revocation of any election to come under the Tax Court survivors' benefit system.

This bill would apply to any Tax Court judge who has elected the Tax Court retirement system and has not yet retired. It also would apply to a former Tax Court judge, Russell E. Train, who did not serve on the Tax Court long enough to qualify for Tax Court retirement, but has been ruled by the Civil Service Commission to be ineligible for civil service retirement benefits because of his Tax Court election.

Effective date

The bill would apply to revocations made after the date of enactment.

Revenue effect

It is estimated that the bill will not have any direct revenue effect.

Departmental position

The Treasury Department supports H.R. 8811.

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[1] In contrast, a U.S. district court judge may receive retirement benefits both as a judge, and under civil service. See 45 Comp. Gen. 383.

21. H.R. 8857—Mr. Jacobs

Treatment of Sales of Corporate Assets in Connection with Certain Liquidations

Present law

Present law (sec. 337 of the Code) in general terms provides that if a corporation adopts a plan of complete liquidation, and within 12 months thereafter distributes to its shareholders all of its assets (less those retained to meet claims), then gain or loss is not to be recognized to the corporation for tax purposes with respect to property it sold (not including regular sales of inventory or similar property) during this 12-month period. The purpose of this provision (sec. 337) is to accord the same tax treatment where a corporation sells its properties and then distributes the proceeds to its shareholders as can be obtained by the corporation first distributing the properties in kind to the shareholders who then sells the property.

Before this provision (sec. 337) was enacted in 1954, the two types of distributions described above often led to quite different tax results. If a corporation sold (or was treated as having sold) its assets before the distribution, a gain (usually capital gain) was realized at the corporate level, and then a tax was also imposed at the shareholder level at the time of the distribution in liquidation on the fair market value of the proceeds distributed to them to the extent this exceeded the basis of their stock. On the other hand, if the corporation distributed the assets in kind, there was no tax at the corporate level but the shareholders paid a capital gains tax based on the fair market value of the properties distributed to the extent this exceeded the shareholders' basis for their stock. Thus, before 1954 two taxes were generally imposed, one at the corporate level and one at the shareholder level, in the first case cited above; while only one tax was paid, the tax at the shareholder level, where the distribution occurred before the sale of the assets in kind.

As a result, Congress decided in 1954 to remove the tax at the corporate level in a complete liquidation (completed within 12 months) where the properties are sold before the distribution.

Under present law, the nonrecognition benefits of this provision are not available in certain cases involving so-called collapsible corporations. A "collapsible corporation" in general is a corporation which shareholders have formed or used with the intention of selling the stock or distributing the property in a liquidation before the corporation has realized potential gain arising from the construction, production, or purchase of property by the corporation. If a corporation is a "collapsible corporation," then gain on the sale of the corporation's stock is taxed as ordinary income rather than as capital gain. Similarly, if the corporation is liquidated the shareholders pay tax on ordinary income and not on capital gain.

The exceptions from nonrecognition of gain at the corporate level in the case of certain "collapsible corporations" are, in general, only applied for property held for a certain period of time. A corporation which has owned "purchased assets" for more than 3 years is not, as a result of such holdings, defined as a "collapsible corporation." Therefore, such a corporation may avail itself of the benefits of nonrecognition in the case of a 12-month liquidation.

The "collapsible corporation" provision also provides relief in the case of the shareholders of a corporation which has "constructed or produced" its assets more than 3 years before the stock is sold by a shareholder. In this case the statute does not exclude such a corporation from the definition of a "collapsible corporation" but, in most respects, gives an equivalent result by providing that in such a case the sale of stock by the shareholders gives rise to capital gain treatment (instead of ordinary income treatment). However, since in the case of these "constructed or produced" assets there is no special provision in the "collapsible corporation" definition excluding these corporations, the nonrecognition provision where liquidation occurs within 12 months is not available because the corporation even 3 years after the completion of the construction or production technically is still defined as a "collapsible corporation."

Issues

The first issue is whether eligibility for nonrecognition treatment of corporate gain realized in connection with the liquidation of a corporation which is or has been a "collapsible corporation" should depend on whether assets are "purchased" or "constructed."

A second issue is whether nonrecognition treatment should be denied to the extent losses have been realized in anticipation of a liquidation.

Explanation of the bill

The bill would provide that nonrecognition treatment on complete liquidation will be available, not only to corporations which would be collapsible corporations but for the fact that they have held their purchased assets for 3 years or more, but also to corporations which are collapsible corporations only because they hold assets on which they completed construction or production 3 years or more ago and where ordinary income treatment would not be applied were the shareholders to sell the stock of the corporation.

The bill also would provide, in general, that the nonrecognition of gains within the 12-month liquidation period is not to apply to the extent that losses in the 2 years immediately prior to the adoption of the plan of complete liquidation were treated as ordinary losses and arose from sales of properties to which this nonrecognition provision (sec. 337) would have applied had they occurred in the liquidation period.

Effective date

The bill would apply to plans of complete liquidation adopted during taxable years beginning after the date of enactment. However, the exception for losses realized within 2 years of adoption of the plan of liquidation would apply only with respect to sales and exchanges of property occurring after the date of enactment.

Revenue effect

The revenue effect of this bill cannot be estimated with confidence. The extension to "collapsible corporations" of the nonrecognition of gain benefit is estimated to result in an annual revenue loss of less than $1 million. The portion requiring losses occurring in the two prior years to be offset against gains realized in the liquidation period is estimated to result in a negligible revenue effect for the first two years after enactment and less than $5 million gain annually thereafter.

Prior committee action

On September 26, 1968, the Ways and Means Committee reported a similar bill (H.R. 18101; H. Rept. 90–1926).

Departmental position

The Treasury Department supports H.R. 8857.