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AMENDING SECTION 124 OF THE INTERNAL REVENUE CODE

JANUARY 22, 1942.—Ordered to be printed

Mr. GEORGE, from the Committee on Finance, submitted the following

REPORT

[To accompany H. J. Res. 257]

The Committee on Finance, to whom was referred the joint resolution (H. J. Res. 257) to amend section 124 of the Internal Revenue Code by repealing subsection (i) thereof as of October 6, 1940 (the date of passage of the Second Revenue Act of 1940, in which the section was originally contained), having considered the same, report favorably thereon and recommend that the joint resolution do pass.

The Senate Committee on Finance during consideration of the proposed legislation received the views and statements of representatives of the War Department, Navy Department, Reconstruction Finance Corporation, and the Treasury Department. The representatives of the agencies concerned with the administration of the subsection (i) of section 124 agreed that the proposed legislation should be enacted.

The purposes of the proposed legislation, as outlined by the report of the House Committee on Ways and Means, are to remove from the prescribed procedure for effecting the amortization for war facilities, the requirement as a condition to amortization, the issuing of certain certificates referred to in subsection (i) of section 124 of the Internal Revenue Code. It is believed that this change in the procedure will greatly aid in the prosecution of the war by making more effective the amortization plan of 1940.

For the further information of the Senate there is appended hereto and made a part of this report excerpts from the report of the House Committee on Ways and Means, reading as follows:

Section 124 of the Internal Revenue Code was enacted in October 1940 to encourage the use of private funds in the rearmament effort then getting under way. In general it provides that any manufacturer may, in computing its net income for tax purposes, take annual deduction of 20 percent of the costs of the facilities erected or acquired after June 10, 1940, in lieu of the depreciation deduction otherwise allowed by law, if the facilities are certified to the Commissioner of Internal Revenue by the Secretary of War or the Secretary of the Navy as necessary in the interest of national defense.[1] Subsection (i), as amended, pro-

[1] Originally the section required joint certificate by either of the Secretaries and the Advisory Commission to the Council of National Defense. This requirement was removed by Public Law 285, 77th Cong.

vides that in case the Government reimburses the manufacturer in whole or in part for the facilities, no amortization deduction shall be allowed unless there is a certificate issued to the Commissioner of Internal Revenue to the effect that the interest of the Government in the future use and disposition of such facilities is adequately protected. In order to dispose of the question as to whether or not reimbursement is made, subsection (i) provides for a conclusive certificate to the Commissioner of Internal Revenue that the manufacturer has not been so reimbursed by the Government.

In practice, subsection (i) has caused considerable confusion, and it is the belief of the representatives who appeared before the committee that as a result of the confusion, manufacturers have refrained and will continue to refrain from acquiring or constructing new facilities with their own funds; that manufacturers have delayed and will continue to delay such expenditure; and, that considerable valuable time is being lost by manufacturers and by Government personnel in administration of the section without any corresponding benefit to the Government.

The repeal of subsection (i) will not in any way enlarge or curtail the basic plan for amortization of war facilities. It will leave the question of amortization to be determined upon proper showing of a need for additional facilities. Upon such a showing a necessity certificate will issue to the manufacturer and whether such manufacturer is a direct contractor with the Government or is merely a subcontractor, or materialman, is not important. The sole question is whether the facilities are necessary to produce the necessary war supplies.

When the section was first introduced in Congress, and as passed by the House, it provided that any facilities for which amortization deductions were taken could not be destroyed, demolished, or substantially altered without the written consent of the Secretary of War or the Secretary of the Navy under the penalty of an amount equal to the adjusted base for tax purposes of the facilities. These provisions were opposed in the Committee on Finance of the Senate and the Senate passed the bill after inserting in lieu of the provisions of the House bill, a section which ultimately became the present subsection (i). It has been found, as was testified by the witnesses appearing before the committee, that compliance with this subsection has and of necessity will delay the determination of the tax situation of the manufacturers so that the main purpose of the bill, namely, determination of the tax situation at the time of expansion, cannot be accomplished. It has been shown that the right to secure the tax amortization is by this section made contingent upon the provisions of contracts which may be entered into over the entire 5-year period.

Subsection (i) was designed to insure that the interest of the United States would be protected in the facilities which are the subject of amortization deductions. It is the opinion of the officials of the War and Navy Departments charged with the procurement that this matter of protecting the Government's interest in facilities which are being paid for by way of Government contracts, can be handled much more advantageously to the Government as a matter of procurement policy at the time the contracts are being negotiated. The situation with regard to the various Government contractors of necessity varies very materially and any attempt to establish a fixed and inflexible standard for contracting is more likely to defeat the interest of the Government than to enhance it. Three directors of the Office of Production Management, charged by the President with cooperating with the War and Navy Departments in the administration of this act, concur in this view. These directors are Mr. Floyd Odlum, of the Division of Contract Distribution; Mr. Donald Nelson, of the Priorities Division; and Mr. Leon Henderson, of Civilian Allocations and Price Administration.

The committee in recommending the passage of this act feels satisfied that there will be no relaxation of the efforts to protect the interest of the Government in this matter, and that the main purpose of the amortization provisions is being defeated by the impossibility, caused by subsection (i), of determining now the future tax situation of the various manufacturers with regard to the facilities which they may acquire with their own funds. It is also thought that the situation with regard to emergency facilities should be the same whether the facilities are installed by subcontractors, materialmen, or prime contractors. As has been shown, the subsection has the effect of making doubtful the tax-amortization deductions in the case of manufacturers who become prime contractors, whereas subcontractors and materialmen can be assured of amortization at the time of expansion, subject only to doubt upon their later becoming prime contractors. This naturally tends to deter these manufacturers from taking direct contracts with the Government, thus interfering with a full, all-out war-production program.

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