

DISTRIBUTIONS BY PERSONAL HOLDING COMPANIES

JUNE 13 (legislative day, APRIL 21), 1947.—Ordered to be printed

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

REPORT

[To accompany H. R. 468]

The Committee on Finance, to whom was referred the bill (H. R. 468) to amend section 115 of the Internal Revenue Code in respect of distributions by personal holding companies, having had the same under consideration, report favorably thereon, without amendment, and recommend that the bill do pass.

By virtue of this action, the committee adopts the Committee on Ways and Means' report which is as follows:

PURPOSE OF THE BILL

The purpose of the bill is to make the provisions of the Internal Revenue Code which determine to what extent a distribution by a personal holding company constitutes a taxable dividend in the hands of its shareholders consistent with the provisions which impose a surtax on the "undistributed subchapter A net income" of such a company.

EXPLANATION OF THE BILL

Section 1

Underlying the policy of surtaxing the undistributed net income of a personal holding company is the principle that all such net income should be distributed to its shareholders and taxed in their hands at rates applicable to the net income of individuals. Statutory net income is not in all cases equivalent to "earnings or profits," the only fund out of which, except in the case of a personal holding company, a distribution qualifying as a "dividend" can be made. Losses from the sale or exchange of capital assets, for example, may decrease earnings or profits but are disallowed, to the extent they exceed gains from such sales or exchanges, in computing statutory net income. The distribution of an amount equal to net income, therefore, may require a distribution out of capital to the extent of all or a part of net income.

To treat a capital distribution as a taxable dividend is justifiable, in the case of a shareholder in a personal holding company, on the ground that if the corporate entity did not intervene, the equivalent amount would be taxable to him and would be computed for tax purposes with a limited allowance for losses from the sale or exchange of capital assets.

In some cases, however, the effect of existing law is to tax to shareholders a larger part of an amount distributed to them out of capital than would be taxed

to the personal holding company as income if it were not distributed. The reason for this is that while a distribution by a personal holding company is taxable to shareholders to the extent of the company's "subchapter A net income," not all of that income need be distributed in order that the company may be free of the surtax. The items deductible, in addition to dividends paid, are the net operating loss credit provided in section 26 (c) (1), the dividend carry-over provided in section 27 (c), and amounts used or set aside for debt reduction, as provided in section 504 (b).

Of these three additional deductions necessary to be taken into account in order to equalize the taxable "dividend" and the "subchapter A net income" subject to surtax if not distributed, the bill referred to your committee included only the net operating loss credit. The inclusion of the other two items in the amended bill reported by your committee is intended to effect the desired equalization in all cases.

Section 2

Under this section, the amendment made to the Internal Revenue Code by section 1 will be effective for all taxable years beginning after December 31, 1943.

Application of the amendment to the back years makes adequate the remedy provided by the Revenue Act of 1943. (Sec. 512 (a) of that act inserted "(to the extent of its subchapter A net income, whether or not a dividend as defined in the preceding sentence)" in I. R. C. 115 (a).) The amendment by the Revenue Act of 1943 was made effective for all taxable years beginning after December 31, 1941.

The limited retroactivity of the amendment made by the bill will not result in any considerable administrative difficulty or expense. The statutory period for filing claims for credit or refund with respect to taxable years beginning after December 31, 1943, or for crediting or refunding by the Commissioner without claim, has not expired.

Section 3

The effect of this section is that no interest shall be allowed or paid in respect of any overpayment resulting from the enactment of the bill.

The position of the Treasury Department with respect to the bill is stated in the following:

"The effect of the proposed amendment is to reduce the amounts considered as dividends to shareholders of personal holding companies to subchapter A net income less the net operating loss credit for the preceding taxable year. This corrects an inequity in existing law and remedial action is considered proper. Accordingly, the Treasury Department is not opposed to the enactment of the proposed bill.

"The underlying theory of H. R. 468, however, appears to be an attempt to correlate the definition of dividends of personal holding companies under section 115 (a) with undistributed subchapter A net income so that dividends of a personal holding company would consist of only so much of its income as would be taxable under subchapter A if such amounts were not distributed. On this basis, the Treasury Department is of the opinion that the amendment should provide also for the exclusion from the definition of dividends certain other items which now are not includible in undistributed subchapter A net income. These items, in addition to the net operating loss credit, are: The dividend carry-over provided in section 27 (c) and the deduction of amounts for retirement of indebtedness provided in section 504 (b). For your information, a draft of a revision of section 1 of H. R. 468, which would exclude all of these items from the definition of a dividend under section 115 (a), is attached."

The amendment made to the bill by your [Ways and Means] committee follows the revised draft referred to.

