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CARRY-OVERS TO REORGANIZED RAILROADS

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

REPORT

[To accompany H. R. 3861]

The Committee on Finance to whom was referred the bill (H. R. 3861) to allow a successor railroad corporation the benefits of certain carry-overs of a predecessor corporation for the purposes of certain provisions of the Internal Revenue Code, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

With the exception of three amendments the bill is the same as the bill as passed the House. The report of the Committee on Ways and Means on the bill is attached hereto as appendix A. A detailed explanation of the bill (which, except with respect to the committee amendments, is equally applicable to the bill as reported by your committee) is included in the House report.

The first amendment in your committee bill is an amendment to subsection (a) of section 1. The bill as passed by the House applies to railroad corporations (as defined in sec. 77m of the National Bankruptcy Act, as amended) which have acquired prior to January 1, 1948, property of other such railroad corporations in a receivership proceeding or in a proceeding under section 77 of the National Bankruptcy Act, as amended, where the basis of the property so acquired is determined under section 113 (a) (20) of the Internal Revenue Code. Inasmuch as the dead line of January 1, 1948, may be too restrictive, that date has been advanced in your committee bill to January 1, 1950.

Another amendment in your committee bill is a clarifying amendment to section 2 of the bill as passed by the House. Section 2 is a provision intended to prevent a railroad reorganized in a receivership or bankruptcy proceeding under a new charter from getting greater tax relief than it would have been entitled to if it had reorganized under its old charter. Section 2 operates to limit the net tax reduction that would otherwise result from an application of the provisions of

section 1 of the bill. Since the carry-overs from the predecessor corporation may benefit the reorganized railroad, using a new charter, after the years to which there are carry-overs from the predecessor, it seems to your committee that it should be made plain that section 2 should be applicable to later years. Accordingly, your committee bill adds a new subsection to section 2, designated subsection (c), which clearly makes section 2 applicable to those taxable years of the successor corporation to which there is a carry-over of a net operating loss or unused excess profits credit under section 1, and to any later taxable year for which a net operating loss deduction or unused excess profits credit adjustment results or is increased by reason of the use in another year of a carry-over permitted under section 1. An example of the application of section 2 to a later taxable year is a case in which a net operating loss carry-over of the predecessor corporation results in a net operating loss deduction of the successor corporation producing an unused excess profits credit carry-over which the successor corporation would otherwise not have had. Another example is a taxable year to which a carry-back may become available, or may be available in a greater amount than would otherwise be the case, by reason of the use of such carry-back being unnecessary or limited for an earlier taxable year of the successor corporation because of a carry-over to such earlier year permitted by section 1.

The only other amendment made by your committee bill is a clerical correction in punctuation.

APPENDIX A

[H. Rept. No. 624, 80th Cong., 1st sess.

The Committee on Ways and Means, to whom was referred the bill (H. R. 3861) to allow a successor railroad corporation the benefits of certain carry-overs of a predecessor corporation for the purposes of certain provisions of the Internal Revenue Code, having had the same under consideration, report it back to the House without amendment and recommend that the bill do pass.

GENERAL STATEMENT

Under existing law, if a railroad corporation is reorganized in a receivership proceeding or in a proceeding under section 77 of the National Bankruptcy Act, as amended, and the reorganization is effected through the organization of a new corporation, any carry-overs of net operating losses or unused excess profits credits of the old corporation cannot be used by the new corporation. The reorganized corporation is regarded as a different taxpayer from the old corporation. Consequently, railroads coming out of receivership or bankruptcy proceedings are treated differently, depending upon whether they can be reorganized under the same charter or under a new charter. The bill removes this discrimination by allowing to railroad corporations, which have acquired, prior to January 1, 1948, property of other railroad corporations in receivership proceedings or proceedings under section 77 of the Bankruptcy Act, the net-operating-loss carry-over and the unused excess-profits-credit carry-over of the railroad corporations from which such property was acquired in such proceedings. The bill applies only where the property for tax purposes has the same basis in the hands of the new corporation as it had in the hands of the old corporation, and the relief is limited to railroad corporations as defined in section 77m of the National Bankruptcy Act.

The relief is retroactively applied to extend the benefits to railroads which have already completed their reorganization. A safeguard is written in the bill which is intended to prevent the railroad reorganized in the receivership or bankruptcy proceedings under a new charter, from getting any greater tax relief than it would have been entitled to, if it had reorganized under its old charter.

It is necessary to give the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, authority to prescribe regulations to determine the manner and the extent in which such carry-overs will be applied. It is intended that the regulations will not be arbitrary but fair and reasonable in their application.

Hearings were held by your committee on May 26, 1947, at which time representatives of the railroads and the Treasury Department were heard.

According to testimony given your committee at the hearings, 33 class I railroads have been involved in bankruptcy or receivership proceedings since the last depression. Of these roads, 18 have been reorganized and 1 has been liquidated. Fourteen are still in the process of reorganization. Of the 18 railroads whose reorganization has been completed, 8 were able to resume operations under their old charters and hence have no problem regarding the use of the carry-over and carry-back provisions. This is also the case as regards the 14 roads still in bankruptcy or receivership. Of the 10 reorganized railroads which were compelled to use new charters in effectuating their reorganization, only 7 have any direct financial interest in this legislation. These are: Akron, Canton & Youngstown Railroad Co., Chicago & Eastern Illinois Railroad Co., Gulf, Mobile & Ohio Railroad Co., Minnesota & St. Louis Railway Co., Minneapolis, St. Paul & Saulte Ste. Marie Railroad Co., Spokane International Railroad, and Wabash Railroad Co. The total amount of potential tax liability involved is $7,500,000, which represents the additional taxes which these 7 railroads otherwise will have to pay merely on account of being compelled under State law to use a new charter on reorganization. The major part of this amount, however, has not been paid into the Treasury and therefore will not necessitate a tax refund. So far as the foregoing 7 railroads are concerned, only carry-overs are involved.

The Treasury has no objection to this legislation and your committee is of the opinion that it should be promptly enacted into law. It is believed that the enactment of this legislation will tend to remove one of the impediments holding railroads in receivership.

DETAILED DISCUSSION OF THE TECHNICAL PROVISIONS OF THE BILL

The bill applies to railroad corporations (as defined in sec. 77m of the National Bankruptcy Act, as amended) which have acquired, prior to January 1, 1948, property of other such railroad corporations in a receivership proceeding or in a proceeding under section 77 of the National Bankruptcy Act, as amended, where the basis of the property so acquired is determined under section 113 (a) (20) of the Internal Revenue Code. The corporation which has thus acquired property is referred to as the successor corporation and the corporation from which the property was so acquired is referred to as the predecessor corporation.

In the case of a successor corporation, section 1 provides for the treatment of the net operating losses and unused excess profits credits of the predecessor corporation as carry-overs to the successor corporation for the purposes of the determination under the Internal Revenue Code of the "net operating loss carry-over" from any taxable year beginning after December 31, 1938, and the "excess profits credit carry-over" and the "unused excess profits credit carry-over" from any taxable year beginning after December 31, 1939, in each case under the law applicable to such taxable year. Thus, the method of computation of the carry-overs as well as the years for which such carry-overs are available (except as provided in subsecs. (b) and (c) of sec. 1) and the computation of the net operating loss deduction and the unused excess profits credit adjustment (called the excess profits credit carry-over for taxable years beginning in 1940) are governed by the provisions of the applicable law under the Internal Revenue Code.

In general, the successor corporation will not be allowed a carry-over to a taxable year, or a carry-over from a taxable year, which would not be allowed to the predecessor corporation under the Internal Revenue Code if the predecessor corporation had been made use of under the receivership proceedings or the proceedings under section 77 of the Bankruptcy Act instead of the successor corporation. Thus, except as provided in subsections (b) and (c) of section 1, carry-overs will be allowed, as provided under the code, only to the two immediately succeeding taxable years, and carry-overs will not be created from any year if the otherwise applicable provisions of the Internal Revenue Code provide no carry-over from such year. The provisions of subsection (a) of section 1 to the effect that there shall be carried over to the successor corporation the net operating losses and unused excess profits credits of the predecessor corporation from the second taxable year preceding its taxable year in which the acquisition occurred

is applicable as to such second preceding year only if subsection (c) of section 1 is applicable.

The carry-overs provided for under subsection (a) of section 1 are to be allowed only in the manner and to the extent provided in regulations prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, as necessary to apply such net operating losses and unused excess profits credits as carry-overs so far as possible as if the predecessor corporation had been made use of in such proceedings instead of the successor corporation. Because of the probable variation in the circumstances presented in each case, it is believed that the rules for the determination of the carry-overs to the successor corporation may best be promulgated in regulations of the Commissioner, giving reasonable and proper effect to the general policy set forth in the bill.

It is not contemplated that where the predecessor corporation has continued in existence after the acquisition that such carry-overs will be denied to the predecessor; rather it is contemplated that in such a case carry-overs shall be available to the successor only to the extent not used by the predecessor, as determined in the regulations with respect to such carry-overs. In any case, the net operating losses and unused excess-profits credits of the predecessor corporation shall not be carry-overs to any taxable year of the successor corporation prior to the taxable year of the successor corporation in which the acquisition occurred.

Subsection (b) of section 1 provides a rule applicable to every case where the taxable year of the successor corporation in which the acquisition occurred and the taxable year of the predecessor corporation in which the acquisition occurred overlap in whole or in part. This rule is designed to clarify the application of subsections (a) and (c) of section 1 in determining the immediately succeeding taxable years to which there may be a carry-over. Under the rule the taxable year of the successor in which the acquisition occurred is the first taxable year succeeding the taxable year of the predecessor in which the acquisition occurred, and subsequent taxable years of the successor follow in order. Any such succeeding taxable year may, of course, also be an "intervening" taxable year for the purposes of the application of sections 122 and 710 (c) of the code.

Subsection (c) of section 1 prescribes a rule for the application of section 1 to cases in which the period, beginning on the first day of the taxable year of the predecessor corporation in which the acquisition occurred and ending on the last day of the taxable year of the successor corporation in which the acquisition occurred, is not more than 12 months. In such a case, subsection (c) of section 1 provides that the number of taxable years to which such net operating loss or unused excess-profits credit is a carry-over shall be three instead of two. This rule is directed to situations in which, in effect, the period in which fall the taxable years (of predecessor and of successor) in which the acquisition occurred would have been but one taxable year of the predecessor corporation if the predecessor corporation had been made use of in the proceeding instead of the successor corporation. In such a case, under existing law, the taxable year of the predecessor in which the acquisition occurred and the taxable year of the successor in which the acquisition occurred are, of course, separate taxable years of two distinct taxpayers, and each would be counted as a taxable year. Accordingly, if it were not for the provisions of subsection (c), the successor would not obtain the benefits of the carry-overs to the extent contemplated by the bill.

The operation of this provision is illustrated by the following example: A predecessor corporation made its returns on the calendar-year basis. The acquisition occurred on August 31, 1940, and the corporation was dissolved on the same date; accordingly, it made a return for the short taxable year ending August 31, 1940. Its successor corporation was organized on July 1, 1940, and made its return for its first taxable year for the short taxable year ending on December 31, 1940; thereafter it made its returns on the calendar-year basis. The predecessor corporation sustained a net operating loss in 1939, which was a carry-over to the predecessor corporation for its taxable year beginning January 1, 1940, and ending August 31, 1940, and (to the extent it remained unused in whole or in part) to the taxable year of the successor corporation beginning July 1, 1940, and ending December 31, 1940 (under the provisions of subsecs. (a) and (b) of sec. 1). By reason of the provisions of subsection (c) of section 1 there may also be a carry-over to the taxable year of the successor corporation beginning January 1, 1941 (the third succeeding taxable year). In any case, the amount to be carried over to such succeeding taxable years of the successor corporation is to be determined under regulations prescribed so as to allow the amount of any such carry-overs to be determined as nearly as possible in the same manner as prescribed in the code. It is contemplated that in such a case,

the carry-over, if any, to the third succeeding taxable year will be computed by making adjustments for each of the two intervening taxable years immediately prior to such third taxable year.

In the application of subsection (c) of section 1 to the carry-over of any unused excess-profits credit, it is contemplated that the regulations will prescribe such adjustments as are necessary in the case of carry-overs from taxable years of less than 12 months in which the acquisition occurred in order that such carry-overs shall, as nearly as possible, be the same in amount as if the predecessor corporation had been made use of in such proceeding instead of the successor corporation. In order to prevent too great a portion of an unused excess-profits credit carry-over being absorbed in intervening taxable years of less than 12 months by reason of the annualization of excess-profits net income for such a short year under section 711 (a) (3), it is also contemplated that the regulations will prescribe a method of adjusting the adjusted excess-profits net income for such intervening years for the purposes of carry-overs to succeeding taxable years under section 710 (c) of the code.

Section 2 of the bill is a provision limiting the effect of the provisions of section 1 of the bill.

Subsection (a) of section 2 provides for a comparison of the aggregate of the income and excess-profits taxes of the successor corporation for any taxable year, determined without regard to any carry-overs permitted by this bill, with the aggregate of the income and excess-profits taxes that would have been imposed on the predecessor corporation for such taxable year if the predecessor corporation had been made use of in the proceeding instead of the successor corporation. Where for any taxable year the successor's aggregate so determined without regard to the carry-overs permitted by the bill is less than the aggregate of the predecessor for such year, each tax, so determined, making up the successor's aggregate for such year shall constitute its tax for such year.

Subsection (b) of section 2 provides that where the successor's aggregate, though not less than the aggregate of the predecessor, would be reduced to a lesser amount than the predecessor's aggregate by an application of section 1 of the bill, the successor's taxes for that year, notwithstanding the provisions of section 1, shall be the taxes that would have been imposed on the predecessor corporation; that is, the same as the taxes that make up the predecessor's aggregate. The comparisons required by section 2 must be made for those taxable years of the successor corporation to which there is a carry-over from the predecessor. Thereafter the comparisons need not be made.

For the purposes of both subsections (a) and (b) of section 2, the taxes that would have been imposed on the predecessor had it been made use of in the proceeding instead of the successor (that is, the taxes that make up the predecessor's aggregate) are to be determined under regulations prescribed by the Commissioner with the approval of the Secretary of the Treasury.

Section 2 of the bill is operative only to limit the net tax reduction that would otherwise result from an application of the provisions of section 1 of the bill, and any carry-overs permitted by section 1 are to be considered as having been used for the year to which section 2 applies to the extent that they would have been used had section 2 not been applicable.

Section 2 may be illustrated by the following examples in which it is assumed that the corporations made their returns on the calendar-year basis:

Example 1. As of the beginning of January 1, 1942, the successor corporation acquired all the properties of the predecessor corporation, the predecessor corporation being dissolved immediately thereafter. The successor corporation was a new corporation, having no capital, no income, and no deductions prior to this acquisition. For 1942, under section 1 of this bill, the successor was allowed a net operating loss carry-over and an unused excess profits credit carry-over from its predecessor. There were no other carry-overs or carry-backs. The taxes of the successor for 1942 computed without regard to the carry-overs provided by this bill were as follows:

Excess profits tax	$1, 800, 000
Normal tax	1, 920, 000
Surtax	1, 280, 000
Aggregate of taxes	5, 000, 000

Assume that if the predecessor corporation had been used in place of the successor in the proceeding, its deductions and its excess-profits credit would be less than that of the successor. The taxes that would have been imposed upon

the predecessor for 1942, computed with its carry-overs, had it been used in place of the successor were as follows:

Excess-profits tax	$2, 250, 000
Normal tax	1, 920, 000
Surtax	1, 280, 000
Aggregate of taxes	5, 450, 000

Since the aggregate of the taxes imposed on the successor without regard to this bill ($5,000,000) is less than the aggregate that would have been imposed on the predecessor if it had been used in place of the successor ($5,450,000), the successor has received full benefit from the proceeding and is not entitled to any tax reduction for such taxable year by the application of this bill.

Example 2. In this example, involving the same corporations for the same taxable year, there is no net operating loss carry-over from the predecessor corporation but there is an unused excess-profits credit carry-over, and the excess-profits credit of the predecessor if it had been used in place of the successor is more than such credit in example 1. The taxes of the successor corporation, computed without regard to any carry-overs, are the same as in example 1. The taxes that would have been imposed on the predecessor for 1942 in this example were as follows:

Excess-profits tax	$900, 000
Normal tax	2, 160, 000
Surtax	1, 440, 000
Aggregate of taxes	4, 500, 000

Section 2 (a) of the bill, illustrated in example 1, does not apply since the aggregate of the taxes imposed on the successor without regard to the bill ($5,000,000) is not less than the aggregate that would have been imposed on the predecessor had it been used in place of the successor in the proceeding ($4,500,000). However, the taxes of the successor computed with the carry-overs for 1942 provided by section 1 of the bill were as follows:

Excess-profits tax	0
Normal tax	$2, 400, 000
Surtax	1, 600, 000
Aggregate of taxes	4, 000, 000

The aggregate of the taxes of the successor computed with the carry-overs provided by section 1 of this bill ($4,000,000) is less than the aggregate of the taxes that would have been imposed on the predecessor if it had been used in the proceeding in place of the successor ($4,500,000). Subsection (b) of section 2 provides that in such a case, where subsection (a) of section 2 does not apply, the taxes of the successor corporation shall be the taxes that would have been imposed on the predecessor corporation if it had been so used in place of the predecessor. Accordingly, the taxes of the successor corporation for such taxable year are as follows:

Excess-profits tax	$900, 000
Normal tax	2, 160, 000
Surtax	1, 440, 000

Of course, if in this example the aggregate of the taxes of the successor computed with the carry-overs provided by section 1 of the bill were not less than the aggregate of the taxes that would have been imposed on the predecessor if it had been used in the proceeding in place of the successor, the taxes of the successor would be its taxes computed with the carry-overs provided by section 1.

Section 3 of the bill provides that where there are two or more predecessor corporations or two or more successor corporations the provisions of sections 1 and 2 of the bill shall be applied only to such extent and subject to such conditions, limitations, and exceptions as the Commissioner, with the approval of the Secretary, may by regulations prescribe. This provision is necessary because of the problems presented where more than one railroad corporation is involved in the proceeding and under the order of the court a combination into a single successor corporation is effected or a single corporation is split into two or more corporations. Thus, in some cases one or more of such predecessor corporations may have filed consolidated returns with another of the predecessor corporations whereas there

may be additional corporations involved which were not so consolidated. In view of the probable variation in the circumstances presented in each case and in view of the Commissioner's experience with many similar types of situations, for example, those arising where corporations file consolidated returns, it is desirable that the Commissioner apply the statute to these cases under regulations prescribed by him with the approval of the Secretary, giving reasonable and proper effect to the general policy set forth in the bill.

Section 4 of the bill extends, for not more than 1 year after the date of the enactment of the bill, the period of limitation as to all years affected by the bill if the refund or credit of any overpayment to the extent resulting from the application of the bill is prevented on the date of its enactment or within 1 year from such date, except where refund or credit is prevented by section 3761 of the Internal Revenue Code relating to compromises. In such cases where section 4 extends the period of limitation, the overpayment shall be refunded or credited if claim therefor is filed within 1 year from the date of enactment of the bill. The overpayment is to be credited or refunded in the manner provided in the Internal Revenue Code. However, no interest is to be allowed or paid on any overpayment or deficiency resulting from the application of the bill. If an overpayment allowed under this bill (for example, in an amount of excess profits tax) results in a deficiency in a related tax (for example, in an amount of income tax) which deficiency, however, would be barred by the statute of limitations such deficiency may be assessed and collected as provided in section 3807 of the Internal Revenue Code.