

AMENDING SECTION 501 (B) (6) OF THE INTERNAL REVENUE CODE

OCTOBER 15 (legislative day, OCTOBER 13), 1949.—Ordered to be printed

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

REPORT

[To accompany H. R. 6073]

The Committee on Finance, to whom was referred the bill (H. R. 6073) to amend section 501 (b) (6) of the Internal Revenue Code, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

PURPOSE

The Internal Revenue Code imposes a surtax on personal holding companies, which are defined as any corporation meeting certain requirements as to source of income and stock ownership, with specified exceptions.

Under existing law a licensed personal finance company under State supervision is not considered to be a personal holding company if at least 80 percent of the gross income of the company—

is lawful interest received from individuals each of whose indebtedness to such company did not at any time during the taxable year exceed \$300 in principal amount, if such interest is not payable in advance or compounded and is computed only on unpaid balances.

The purpose of the bill is to modify the language of this exception to reflect changes in State laws regulating the activities of personal finance companies that have been made over the past several years, and to impose a new restriction with respect to loans that a personal finance company may make to a stockholder without being classified as a personal holding company.

The need for the proposed legislation is set forth in the favorable report of the Treasury Department to the House Ways and Means Committee on H. R. 3801. H. R. 3801 is identical with section 1 of H. R. 6073. In its report the Treasury Department suggested that a provision be added to make the proposed amendment applicable with respect to taxable years beginning after December 31, 1948. Section 2 of H. R. 6073 incorporates the Treasury's suggestion.

2 AMEND SECTION 501 (B) (6) OF THE INTERNAL REVENUE CODE

The Treasury report referred to above is as follows:

TREASURY DEPARTMENT,
Washington.

Hon. R. L. DOUGHTON,
*Chairman, Committee on Ways and Means,
House of Representatives, Washington, D. C.*

MY DEAR MR. CHAIRMAN: Reference is made to the letter of March 30, 1949, from Mr. Charles W. Davis, clerk of your committee, enclosing two copies of H. R. 3801 (81st Cong., 1st sess.) entitled "A bill to amend section 501 (b) (6) of the Internal Revenue Code." Mr. Davis requests that your committee be furnished a report with respect to the proposed legislation.

If enacted, the bill would amend section 501 (b) (6) of the Internal Revenue Code, relating to exceptions to the general rule of section 501 (a) defining the term "personal holding company" for the purposes of chapter 1 and subchapter A of chapter 2 of such code, the latter of which imposes a surtax on personal holding companies.

Under existing law, a licensed personal finance or small-loan company is not included within the definition of a personal holding company, provided it meets certain tests, one of which is that at least 80 percent of its gross income is lawful interest received from individuals each of whose indebtedness to such company did not at any time during the taxable year exceed \$300 in principal amount. In substance, the proposed amendment would do two things: First, it would eliminate the \$300 limitation in those cases where the applicable State law prescribes a definite limit in a different amount, which amount would be accepted as controlling, and, second, provide that only 60 percent of the company's gross income need conform to the above test. It would add the requirement, however, that 80 percent of the company's gross income must be lawful interest received from loans made to individuals in accordance with the provisions of applicable State law.

It would seem that the proposed amendment does no more than modify the provisions of section 501 (b) (6) in such a way as to make them conform to the provisions of State law, as they now exist, which govern the activities of such companies. In the first place, the applicable dollar limit under the laws of many States is no longer \$300. Secondly, in many States licensed personal finance or small-loan companies, in addition to their small-loan business proper, are authorized to transact ordinary loan businesses of a type appropriate to banks or other lenders. Banks, of course, are excepted from the definition of a personal holding company and, under the provisions of section 501 (b) (7), companies, a substantial part of the business of which is the making of loans and discounts, are also excepted. It appears expedient to revise section 501 (b) (6) to relieve personal finance companies from discriminatory taxation upon that portion of their business which is similar to that of other institutions now exempt under such section.

The proposed amendment would also add a further test requiring that loans to a person who is a shareholder in such company during the taxable year by or for whom 10 percent or more in the value of its outstanding stock is owned directly or indirectly outstanding at any time during the taxable year shall not exceed \$5,000 in principal amount. The added test corresponds with that prescribed with respect to a loan or investment corporation which is excepted under section 501 (b) (7).

In the view of the Treasury Department, the proposed amendments are desirable since it is not the purpose of the law to impose the personal holding company surtax upon companies which are in fact true operating companies. Existing law imposes a penalty upon a company operating in a State which prescribes some limit higher than \$300 upon loans which will be treated as so-called small loans under its laws.

Under the circumstances, the Treasury Department is in favor of enactment of H. R. 3801. However, it is suggested that a provision be added to make such amendment of the code applicable with respect to taxable years beginning after December 31, 1948.

The Director, Bureau of the Budget, has advised the Treasury Department that there is no objection to the presentation of this report.

If further correspondence relative to this matter is necessary, please refer to IR:IT:P:CA-CJM.

Very truly yours,

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

