

AMENDMENT OF SECTION 223 OF THE REVENUE ACT OF 1950

JULY 29, 1955.—Ordered to be printed

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

R E P O R T

[To accompany H. R. 2553]

The Committee on Finance, to whom was referred the bill (H. R. 2553) to amend section 502 (f) of the Internal Revenue Code of 1939, as amended by section 223 of the Revenue Act of 1950, relating to the use of corporation property by a shareholder, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

By virtue of this act, the Committee on Finance accepts the report of the Committee on Ways and Means, which is as follows:

PURPOSE OF BILL

H. R. 2553 qualifies the application of section 502 (f) of the Internal Revenue Code of 1939 to provide that personal holding company income is not to include rents received during taxable years ending after December 31, 1945, and before January 1, 1954, if the rents are for the use of property of a corporation where the lessee uses the property in the operation of a bona fide commercial, industrial, or mining enterprise. The same treatment was provided for the years 1946 through 1949 and somewhat similar treatment is provided for 1954 and subsequent years by the Internal Revenue Code of 1954.

REASONS FOR BILL

Both the 1939 and 1954 codes provide that if a closely held corporation receives most of its income from such sources as dividends, interest, certain rents, and royalties, indicating that the company is being used as an "incorporated pocket-book," it is designated for tax purposes as a personal holding company. Generally, such a company, in addition to paying the regular corporate income taxes, is subject to an additional penalty tax at the rate of 75 percent or 85 percent on its undistributed income.

Included in personal holding company income under section 502 (f) of the 1939 code (sec. 543 (a) (6) of the 1954 code) are amounts received for the use of the corporation's property where 25 percent or more of the stock of the corporation is held by the individual renting the corporate property. However, the Revenue Act of 1950 provided an exception to this rule for taxable years ending after 1945 and before 1950. The exception provided that personal holding company income,

2 AMENDMENT OF SECTION 223 OF REVENUE ACT OF 1950

despite this 25-percent rule, was not to include property leased by a corporation to an individual if he used the property in the operation of a bona fide commercial, industrial, or mining enterprise. The Senate Finance Committee's report on the Revenue Act of 1950 indicated that this exception to the general 25-percent rule was provided because "* * * through a set of fortuitous circumstances, corporations have become closely held and also have rented most of their assets for use in the operation of businesses to the individuals holding the stock of the companies. Thus, unwittingly the corporations have become personal holding companies and subject to the penalty tax."

This same problem was recognized in the Internal Revenue Code of 1954 with respect to taxable years beginning after December 31, 1953, and ending after August 16, 1954. In this case, however, the exception to the 25-percent rule is expressed in somewhat different terms. For 1954 and subsequent years the 25-percent rule with respect to use of corporate property by a shareholder is to apply only to a corporation which has personal holding company income, wholly apart from rents or other compensation for the use of property, in excess of 10 percent of its gross income. The report of your committee on the Internal Revenue Code of 1954 indicates that this amendment is designed to take care of hardship cases which frequently arise where a corporation rents property to its principal stockholders. Your committee's report on the 1954 code states: "In the absence of appreciable amounts of other investment income, rental income received from shareholders does not constitute a tax avoidance problem."

As a result of the 1950 and 1954 actions an anomalous situation is presented whereby the rental of property by a company to its principal stockholders is permitted in certain cases with respect to the years 1946 through 1949 and for 1954 and subsequent years, but is classified as personal holding company income for the years 1950 through 1953.

EXPLANATION OF BILL

This bill removes this anomalous situation by providing that for the years ending after December 31, 1945, and before January 1, 1954, section 502 (f) of the 1939 code (which is the subsection providing that compensation for the use of corporate property by a shareholder holding 25 percent or more of the stock of the corporation is to be classified as personal holding company income) is not to apply with respect to rents received for the use by the stockholder in the operation of a bona fide commercial, industrial, or mining enterprise of the property of the corporation.

It is estimated that any revenue loss resulting from the enactment of this bill will be negligible.

This bill has been reported unanimously by your committee.

CHANGES IN EXISTING LAW

In compliance with subsection 4 of rule XXIX of the Standing Rules of the Senate, changes in existing law made by the bill are shown as follows (existing law proposed to be omitted is enclosed in black brackets; new matter is printed in italics; existing law in which no change is proposed is shown in roman):

SECTION 223 OF THE REVENUE ACT OF 1950

SEC. 223. PERSONAL HOLDING COMPANY INCOME.

Section 502 (f) of the Internal Revenue Code of 1939 (relating to use of corporation property by a shareholder) shall not apply with respect to rents received during taxable years ending after December 31, 1945, and before January 1, [1950] 1954, if such rents were received for the use by the lessee, in the operation of a bona fide commercial, industrial, or mining enterprise, of property of the taxpayer.

