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No. 1254

SALE OF RESIDENCE BY MEMBERS OF THE ARMED FORCES

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. 257]

The Committee on Finance, to whom was referred the bill (H. R. 257) to amend section 112 (n) (8) of the Internal Revenue Code of 1939 to provide that in certain cases of a sale or exchange of a taxpayer's residence, certain periods of limitation shall not run against the taxpayer while he is on extended active duty in the Armed Forces, having considered the same, report favorably thereon with amendments and recommend that the bill do pass.

SECTION 1

Section 1 of the bill removes an unintentional discrimination against those in the Armed Forces of the United States who sold or exchanged their residences prior to January 1, 1954. For such persons, but not for those who have sold such residences since that time, the suspension of the time restrictions for replacing of the residences without tax consequences ended as of December 31, 1953. This bill provides that the replacement period under the 1939 code, as is presently provided under the 1954 code, is to be available to those on active duty with the Armed Forces during a period when an induction law is in effect but not more than 4 years.

REASONS FOR SECTION 1

Under both the 1939 code and the 1954 code, the recognition of capital gain on the sale of a taxpayer's principal residence is postponed in most cases, provided the proceeds of the sale are used to acquire a new residence within 1 year or to construct a residence within 18 months. In the case of qualifying sales the basis of the old residence is carried over to the new residence.

In the case of members of the Armed Forces both the 1939 and 1954 codes (sec. 112 (n) (8) of the 1939 code and sec. 1034 (h) of the 1954 code) provide that the replacement period will not if the taxpayer or his spouse is on extended active duty after the sale of the old residence. However, in no case is the replacement period postponed for more than 4 years after the date of sale of the old residence.

The 1939 code, however, suspended the running of this replacement period only until January 1, 1954. The 1954 code, in view of the continuance of the draft and the recall of Reserves to active duty, removed this January 1, 1954, date altogether and provided instead for the postponement of the running of the replacement period during any period in which individuals are liable for induction into the Armed Forces. The requirement that the period of suspension is not extended beyond 4 years from the date of sale of the old residence is retained.

The nonrecognition of gain under section 1034 (a) of the 1954 code applies only to sales of residences after December 31, 1953. But the 1939 code continues to apply to cases where the sale of a residence occurred prior to January 1, 1954, and for such cases the January 1, 1954, cutoff date continues to apply. As a result those who, while on extended active duty, sold their residences prior to January 1, 1954, are denied the privilege of postponing the running of the replacement period beyond December 31, 1953, while those who sold their residences after December 31, 1953, may postpone the running of this period for as much as 4 years if they remain on active duty that long.

SECTION 2

Section 2 of the bill adds a new section to the 1954 code which is complementary to section 1341 of the 1954 code.

Section 1341 deals with the situation where a taxpayer mistakenly includes an item in his gross income of a prior year(s), and in a later year is required to restore the money or property which gave rise to the item of income in the prior year. Where the restored item amounts to \$3,000, or more, section 1341 allows the taxpayer the option of: (1) deducting the restored amount in the tax year it is restored to a third party; or (2) computing the tax for the restoration year without deducting the amount restored, and then lowering the tax of the taxable (restoration) year by the amount of decrease in tax caused by excluding the restored item(s) from the income of the earlier year(s) in which reported.

The proposed bill would give a similar option to a taxpayer who, mistakenly thinking a third party had a claim of right to money or property, takes a deduction for the item(s) in an earlier year(s). In the tax year taxpayer recovers the item(s) previously deducted.

Where the recovered item amounts to \$3,000, or more, the proposed bill would allow the taxpayer, in computing the tax for the tax year (recovery year), the option of: (1) including the recovered item in the income of the tax year; or (2) excluding the amount from the tax year's income and adding the amount of tax caused by putting the item(s) back in the prior year(s).

However, section 2 is limited to situations where an item was deducted from gross income for a prior taxable year (or years) because it appeared that another person held an unrestricted right to such item as a result of a court decision in a patent infringement case

suit (whether or not the taxpayer is a party to such suit) which court decision was later reversed on the ground that such decision was induced by fraud or undue influence. Interest will be computed on the increase in tax resulting solely from the elimination of such item as a deduction for the prior taxable year. This section applies with respect to taxable years after December 31, 1954.

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 112 (N) OF THE INTERNAL REVENUE CODE OF 1939

(n) GAIN FROM SALE OR EXCHANGE OF RESIDENCE.—

(1) NONRECOGNITION OF GAIN.—If property (hereinafter in this subsection called "old residence") used by the taxpayer as his principal residence is sold by him and within a period beginning one year prior to the date of such sale and ending one year after such date, property (hereinafter in this subsection called "new residence") is purchased and used by the taxpayer as his principal residence, gain (if any) from such sale shall be recognized only to the extent that the taxpayer's selling price of the old residence exceeds the taxpayer's cost of purchasing the new residence.

* * * * *

(8) MEMBERS OF ARMED FORCES.—The running of any period of time specified in paragraph (1) or (2) (other than the one year referred to in paragraph (2) (F)) of this subsection shall be suspended during any time that the taxpayer (or his spouse if the old residence and the new residence are each used by the taxpayer and his spouse as their principal residence) serves on extended active duty with the Armed Forces of the United States after the date of the sale of the old residence and [before January 1, 1954, except that any such period] *during an induction period (as defined in section 112 (c) (5) of the Internal Revenue Code of 1954), except that any such period of time as so suspended shall not extend beyond the date four years after the date of the sale of the old residence.* For the purpose of this paragraph, the term "extended active duty" means any period of active duty pursuant to a call or order to such duty for a period in excess of ninety days or for an indefinite period.

