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SENATE

{ REPORT
No. 1181

USE OF CORPORATION PROPERTY BY A SHAREHOLDER

JANUARY 23, 1958.—Ordered to be printed

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

REPORT

[To accompany H. R. 7762]

The Committee on Finance, to whom was referred the bill (H. R. 7762) to amend section 223 of the Revenue Act of 1950 so that it will apply to taxable years ending in 1954 to which the Internal Revenue Code of 1939 applies, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

I. GENERAL STATEMENT

Section 502 (f) of the Internal Revenue Code of 1939 already provides for years ending after December 31, 1945, and before January 1, 1954, that personal holding company income does not include rents 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. This bill makes this same rule applicable to years ending in 1954 to which the Internal Revenue Code of 1939 applies. Somewhat similar treatment presently is available under the 1954 Code for years beginning after December 31, 1953, and ending after August 16, 1954.

II. 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 pocketbook," 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, 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. Your 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 years beginning in 1954 and ending after August 16, 1954, and also for subsequent years the 25-percent rule with respect to use of corporate property by a shareholder applies 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 the House Ways and Means Committee on the Internal Revenue Code of 1954 indicates that this amendment was designed to take care of hardship cases which frequently arise where a corporation rents property to its principal stockholders. That committee's report on the 1954 code stated:

In the absence of appreciable amounts of other investment income, rental income received from shareholders does not constitute a tax avoidance problem.

Public Law 370, 84th Congress, amended the Revenue Act of 1950 to extend the exemption from section 502 (f) of the 1939 code to taxable years ending before January 1, 1954. This was intended to remove the anomalous situation 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 was classified as personal holding company income for the years 1950 through 1953. It was the intention of Public Law 370 to remove completely this anomaly for all years intervening between the 1950 action and the Internal Revenue Code of 1954.

By an oversight, however, Public Law 370 did not make the rule provided by the Revenue Act of 1950 applicable to those years ending after December 31, 1953, which are not covered by the 1954 code. In this area are fiscal years beginning in 1953 and ending in 1954 and short years beginning in 1954 and ending on or before August 16, 1954.

The bill corrects this oversight by extending the exception presently available for years ending after 1945 and before 1954 to years ending after December 31, 1953, to which the 1939 code applies. Thus

section 502 (f) of the 1939 code (which is the subsection under which compensation for the use of corporate property by a shareholder holding 25 percent or more of the stock of the corporation is classified as personal holding company income) is not to apply to these years ending in 1954 but governed by the 1939 code 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. No interest is to be paid on overpayments resulting from this act.

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

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 italic; existing law in which no change is proposed is shown in roman):

SECTION 223 OF THE REVENUE ACT OF 1950 AS AMENDED

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, 1954,] *to which the Internal Revenue Code of 1939 applies*, 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.

