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DISTRIBUTIONS OF STOCK PURSUANT TO ORDERS ENFORCING THE ANTITRUST LAWS

SEPTEMBER 21, 1961.—Ordered to be printed

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

REPORT

together with

MINORITY VIEWS

[To accompany H.R. 8847]

The Committee on Finance, to whom was referred the bill (H.R 8847) to amend the Internal Revenue Code of 1954 so as to provide that a distribution of stock made to an individual (or certain corporations) pursuant to an order enforcing the antitrust laws shall not be treated as a dividend distribution but shall be treated as a return of capital; and to provide that the amount of such a distribution made to a corporation shall be the fair market value of the distribution, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

I. GENERAL STATEMENT

H.R. 8847, as passed by the House, would add several new provisions to the Internal Revenue Code of 1954 relating to the income tax treatment of the recipients of stock distributed in an antitrust distribution. (An antitrust distribution is a distribution made in pursuance of a court order enforcing the antitrust laws.) At the request of the administration, the bill has been limited to distributions in the *Du Pont* antitrust case (*United States* v. *E. I. du Pont de Nemours and Company, et al.*, 353 U.S. 586 (1957) and 365 U.S. 806 (1961)). The bill only applies if the order, pursuant to which the distribution is made, requires the divestiture of stock to be completed within 3 years or less from the date the order becomes final.

Section 1 of the bill would add to the code a new section 1111 which provides, in general, that where stock is received in an antitrust dis-

tribution by an individual shareholder (or any shareholder which is not entitled to the corporate dividends received deduction), the distribution will be treated as a return of capital, and its full fair market value will reduce the basis of the stock with respect to which it is made. If, however, the fair market value of the stock distributed exceeds the basis of the stock with respect to which the distribution is made, then gain is recognized to the extent of the excess and is taxable as any other gain would be. (This is the same as the income tax treatment of distributions made by corporations which have no earnings and profits.)

This treatment may affect the taxation of individuals who do not hold title to the stock. For example, if under the terms of a trust instrument, and all the other circumstances of the case, all capital gains of the trust are taxable to the beneficiary (whether or not distributed), then a distribution of antitrust stock to the trustee would result in capital gains income to the beneficiary and not to the trustee if the requirements of the statute are otherwise satisfied.

The return of capital treatment provided for by new section 1111 may be illustrated by an example. An individual owns a single share of the stock of Du Pont which has a basis to him of $100. In a distribution pursuant to the terms of an antitrust order he receives from that corporation 1⅓ shares of the General Motors stock. Because of the distribution his basis for the Du Pont stock ($100) is reduced by the fair market value of the 1⅓ shares of General Motors stock received ($60), so that after the distribution his basis for the Du Pont stock is $40 ($100 minus $60). Thus, no income or gain is recognized to this shareholder because of the distribution. However, if his basis for the Du Pont stock were $40, then on the receipt of $60 worth of General Motors stock a gain of $20 ($60 minus $40) would be recognized. (Under existing law, in both cases the shareholder would have $60 of dividend income taxed at ordinary income rates.) Of course the basis of the stock received to the recipient is always its fair market value. Without regard to the shareholder's basis for his Du Pont stock, his holding period, for income tax purposes for the General Motors stock received, begins when he receives it.

The special tax treatment of individuals will not apply to a distribution of General Motors stock which is made in lieu of an ordinary cash dividend distribution which would have been made if the bill had not been enacted. This is provided for by subsection 1111(c)(1) which would be added to the code by the bill.

Section 2 of the bill would add to the code new section 301(f) which provides special treatment for a corporation entitled to the dividends received deduction which is a party to an antitrust court proceeding and which receives stock in an antitrust distribution. In such a case the amount of dividend income and the amount of the dividends received deduction will both be determined by the fair market value of the stock distributed (without regard to the basis of such stock in the hands of the distributing corporation). However, the basis of the stock to the receiving corporation will be the fair market value of such stock diminished by that portion of the dividends received deduction attributable to the unrealized appreciation (if any) in the hands of the distributing corporation.

Under existing law a dividend in kind paid by one corporation to another is measured by the basis of the property distributed in the

hands of the distributing corporation if this basis is less than fair market value. Accordingly, under present law if Du Pont Co. were to distribute one share of General Motors stock (having a fair market value of $45) as a dividend to Christiana Securities Corp., and this stock had a basis to Du Pont Co. of $2, this would be a $2 dividend to Christiana. The 85-percent dividends received deduction would be $1.70, so that only 30 cents would be subject to tax at the full corporate rate because of the receipt of the General Motors stock. Thus, the tax would be 16 cents (52 percent of 30 cents) to Christiana, although the General Motors stock had a fair market value of $45.

Under section 301(f), which would be added by the bill, in the case of an antitrust distribution ordered in a suit to which Christiana is a party, the tax to Christiana would be computed on the $45 fair market value of the stock received. This entire amount ($45) would go into dividend income and there would be a dividends received deduction of 85 percent of $45 ($38.25), so that tax at the full corporate rate would be paid on $6.75 ($45 minus $38.25). The tax would, therefore, be 52 percent of $6.75 or $3.51. Because of section 1223(2) of the Internal Revenue Code, Christiana's holding period for the General Motors stock received would include the period during which the General Motors stock was held by Du Pont.

Section 3 of the bill would add to the code technical amendments relating to the new section 301(f).

The amendments made by the bill apply with respect to distributions made after the date of enactment.

II. REASONS FOR THE BILL

The problems arising out of antitrust distributions were called to the attention of Congress by the two decisions of the Supreme Court in the case of *United States* v. *E. I. du Pont de Nemours and Company, et al.* (353 U.S. 586 (1957) and 365 U.S. 806 (1961)).

Du Pont is a large chemical company engaged (among other things) in the manufacture of automotive paints and fabrics. It owns about 23 percent of the common stock of General Motors, nearly all of which it acquired about 40 years ago. General Motors is one of the largest users of automotive paints and fabrics in the country.

In 1949 the Department of Justice filed a complaint in an antitrust action against Du Pont. In 1957, after protracted litigation, the Supreme Court found that Du Pont's ownership of 23 percent of the stock of General Motors was a violation of section 7 of the Clayton Act, since this ownership might enable Du Pont to prevent other suppliers of automotive paints and fabrics from selling to General Motors. The court reached this conclusion although it believed that "* * * all concerned in high executive posts in both companies acted honorably and fairly * * *." The decision accordingly returned the case to the district court for proper equitable relief.

In the district court the Department of Justice proposed that Du Pont distribute its General Motors stock to its shareholders over a 10-year period. However, impressed by the harsh income tax consequences that would result from such distributions, the district court declined to order a divesture and instead entered a decree under the terms of which Du Pont would refrain from voting the stock of General Motors but such stock would be voted instead directly by the Du Pont shareholders.

The United States again appealed and on May 22, 1961, the Supreme Court ruled that no less a remedy than complete divestiture is required and that such divestiture must be completed within 10 years. Thus, at the present time Du Pont will be required to rid itself of 63 million shares of General Motors stock within the period mentioned.

The problem of getting rid of such a huge amount of stock without upsetting the market is by no means an easy one. It seems that under any plan Du Pont will have to distribute at least some of the General Motors stock to its shareholders. It should be observed that an individual Du Pont shareholder receiving General Motors stock will (under existing law) be taxed on dividend income to the extent of fair market value of the stock received. Thus, he will owe a large tax but may have no cash in hand with which to pay it. In these circumstances it will frequently happen that he will be obliged to sell some or all of the stock received. Your committee believes that this result is harsh, insofar as the Du Pont shareholders are concerned, since these shareholders were not violators of the antitrust laws and were not parties to the proceedings. In addition, serious harm would result to the General Motors shareholders. It is clear that if a large number of persons are at the same time compelled to sell General Motors stock, the increase in the supply of this stock will appreciably depress its price to the detriment of the many General Motors shareholders who are not guilty of any wrongdoing. It is the purpose of this bill to prevent both the application of an unreasonably high tax rate to the individual shareholders of Du Pont and to save the General Motors shareholders from having the value of their investment seriously diminished by reason of events beyond their control.

Under the amendment made by the bill, the only individual shareholders who will owe any tax on the receipt of the General Motors stock will be those whose basis for their Du Pont stock is less than the value of the General Motors stock to be distributed to them. Since in recent years the market price of the Du Pont stock has been high, in general, only shareholders who acquired the Du Pont stock before 1950 will pay any tax. As a result, a very large portion of the recipients of the General Motors stock will not be under any pressure to sell this stock, so that the depressing effect on the market will be minimized.

Further market stability is expected to result from the enactment of the bill due to the fact that a major part of the Du Pont stock held at a very low basis is held by a relatively small group of shareholders. It is believed likely that this group will be able to sell some General Motors stock in an organized and orderly manner through underwriters.

For the reasons given, your committee believes that the enactment of the bill will make it possible to distribute the General Motors stock to the individual shareholders without unfair consequences to these shareholders and without damage to investors in General Motors stock. Your committee also believes that enactment of the bill will make it possible to accomplish this within the 3-year period fixed in the bill.

Christiana Corp. is the largest corporate shareholder of Du Pont, owning about one-third of the outstanding stock. For this reason, if Du Pont distributes all of the General Motors stock owned by it,

Christiana will receive about 20 million shares of General Motors. The Department of Justice is expected to seek a court order requiring Christiana to divest itself of the General Motors stock by selling such stock. However, the court may direct Christiana to distribute some or all of the General Motors stock received in the distribution. If this were to occur, under terms of the amendments made by the bill the individual shareholders of Christiana would be treated in the same manner as individual shareholders of Du Pont were treated in the antitrust distribution made by it. Your committee wishes to make it very clear that it expresses no opinion as to what particular method of divestiture of General Motors stock by Du Pont or by Christiana is appropriate. It is contemplated by your committee that all issues dealing with the manner of divestiture are to be determined judicially, solely with reference to the antitrust principles announced by the Supreme Court in the *Du Pont* case.

It should be observed that under the amendments made by the bill, Christiana will pay somewhat more tax on the receipt of the General Motors stock than it would pay if such amendments had not been made. Your committee believes that this is justified by the fact that Christiana's individual shareholders will receive the special "return of capital" treatment provided for in the bill, if Christiana should be ordered to distribute to them the stock received by it. However, Christiana will pay the additional tax whether or not a distribution by it is ordered.

The amendments made by the bill provide only for distributions in court proceedings which were begun on or before January 1, 1959. Your committee has not yet reached a definite opinion as to what relief, if any, should be given to other taxpayers who may be required to distribute stock pursuant to the antitruse laws. However, it should be observed that in many antitrust situations the corporation wnich would be required to distribute stock of another corporation would own more than 80 percent of such stock. Thus, in many cases the distribution of the stock would be tax free to the shareholders because of section 355 of the Internal Revenue Code. (That section permits the tax free distribution of the stock of an 80-percent owned subsidiary when parent and subsidiary have each been engaged in the active conduct of a trade or business for more than 5 years.)

The Treasury Department and the Department of Justice do not object to enactment of the substitute for the committee amendment to H.R. 8847.

III. 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, as reported, 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):

INTERNAL REVENUE CODE OF 1954

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Subchapter C—Corporate Distributions and Adjustments

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SEC. 301. DISTRIBUTIONS OF PROPERTY.

(a) IN GENERAL.—Except as otherwise provided in this chapter, a distribution of property (as defined in section 317(a)) made by a corporation to a shareholder with respect to its stock shall be treated in the manner provided in subsection (c).

(b) AMOUNT DISTRIBUTED.—

(1) GENERAL RULE.—For purposes of this section, the amount of any distribution shall be—

(A) NONCORPORATE DISTRIBUTEES.—If the shareholder is not a corporation, the amount of money received, plus the fair market value of the other property received.

(B) CORPORATE DISTRIBUTEES.—If the shareholder is a corporation, the amount of money received, plus whichever of the following is the lesser:

(i) the fair market value of the other property received; or

(ii) the adjusted basis (in the hands of the distributing corporation immediately before the distribution) of the other property received, increased in the amount of gain to the distributing corporation which is recognized under subsection (b) or (c) of section 311.

(2) REDUCTION FOR LIABILITIES.—The amount of any distribution determined under paragraph (1) shall be reduced (but not below zero) by—

(A) the amount of any liability of the corporation assumed by the shareholder in connection with the distribution, and

(B) the amount of any liability to which the property received by the shareholder is subject immediately before, and immediately after, the distribution.

(3) DETERMINATION OF FAIR MARKET VALUE.—For purposes of this section, fair market value shall be determined as of the date of the distribution.

(c) AMOUNT TAXABLE.—In the case of a distribution to which subsection (a) applies—

(1) AMOUNT CONSTITUTING DIVIDEND.—That portion of the distribution which is a dividend (as defined in section 316) shall be included in gross income.

(2) AMOUNT APPLIED AGAINST BASIS.—That portion of the distribution which is not a dividend shall be applied against and reduce the adjusted basis of the stock.

(3) AMOUNT IN EXCESS OF BASIS.—

(A) IN GENERAL.—Except as provided in subparagraph (B), that portion of the distribution which is not a dividend, to the extent that it exceeds the adjusted basis of the stock, shall be treated as gain from the sale or exchange of property.

(B) DISTRIBUTIONS OUT OF INCREASE IN VALUE ACCRUED BEFORE MARCH 1, 1913.—That portion of the distribution which is not a dividend, to the extent that it exceeds the adjusted basis of the stock and to the extent that it is out of increase in value accrued before March 1, 1913, shall be exempt from tax.

(d) BASIS.—The basis of property received in a distribution to which subsection (a) applies shall be—

(1) NONCORPORATE DISTRUBUTEES.—If the shareholder is not a corporation, the fair market value of such property.

(2) CORPORATE DISTRIBUTEES.—If the shareholder is a corporation, whichever of the following is the lesser:

(A) the fair market value of such property; or

(B) the adjusted basis (in the hands of the distributing corporation immediately before the distribution) of such property, increased in the amount of gain to the distributing corporation which is recognized under subsection (b) or (c) of section 311.

(e) EXCEPTION FOR CERTAIN DISTRIBUTIONS BY PERSONAL SERVICE CORPORATIONS.—Any distribution made by a corporation, which was classified as a personal service corporation under the provisions of the Revenue Act of 1918 or the Revenue Act of 1921, out of its earnings or profits which were taxable in accordance with the provisions of section 218 of the Revenue Act of 1918 (40 Stat. 1070), or section 218 of the Revenue Act of 1921 (42 Stat. 245), shall be exempt from tax to the distributees.

(f) SPECIAL RULES FOR DISTRIBUTIONS OF ANTITRUST STOCK TO CORPORATIONS.—

(1) DEFINITION OF ANTITRUST STOCK.—For purposes of this subsection, the term "antitrust stock" means stock received, by a corporation which is a party to a suit described in section 1111(d) (relating to definition of anititrust order), in a distribution made after September 6, 1961, either pursuant to the terms of, or in anticipation of, an antitrust order (as defined in subsection (d) of section 1111).

(2) AMOUNT DISTRIBUTED.—Notwithstanding subsection (b)(1) (but subject to subsection (b)(2)), for purposes of this section the amount of a distribution of antitrust stock received by a corporation shall be the fair market value of such stock.

(3) BASIS.—Notwithstanding subsection (d), the basis of antitrust stock received by a corporation in a distribution to which subsection (a) applies shall be the fair market value of such stock decreased by so much of the deduction for dividends received under the provisions of section 243, 244, or 245 as is, under regulations prescribed by the Secretary or his delegate, attributable to the excess, if any, of—

(A) the fair market value of the stock, over

(B) the adjusted basis (in the hands of the distributing corporation immediately before the distribution) of the stock, increased

by the amount of gain which is recognized to the distributing corporation by reason of the distribution.

[(f)] (g) SPECIAL RULES.—

(1) For distributions in redemption of stock, see section 302.

(2) For distributions in partial or complete liquidation, see part II (sec. 331 and following).

(3) For distributions in corporate organizations and reorganizations, see part III (sec. 351 and following).

(4) For partial exclusion from gross income of dividends received by individuals, see section 116.

SEC. 312. EFFECT ON EARNINGS AND PROFITS.

(a) GENERAL RULE.—Except as otherwise provided in this section, on the distribution of property by a corporation with respect to its stock, the earnings and profits of the corporation (to the extent thereof) shall be decreased by the sum of—

(1) the amount of money,

(2) the principal amount of the obligations of such corporation, and

(3) the adjusted basis of the other property,

so distributed.

* * * * * * *

(k) SPECIAL ADJUSTMENT ON DISPOSITION OF ANTITRUST STOCK RECEIVED AS A DIVIDEND.—If a corporation received antitrust stock (as defined in section 301(f)) in a distribution to which section 301 applied, and the amount of the distribution determined under section 301(f)(2) exceeded the basis of the stock determined under section 301(f)(3), then proper adjustment shall be made, under regulations prescribed by the Secretary or his delegate, to the earnings and profits of such corporation at the time such stock (or other property the basis of which is determined by reference to the basis of such stock) is disposed of by such corporation.

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Subchapter G—Corporations Used To Avoid Income Tax on Shareholders

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SEC. 535. ACCUMULATED TAXABLE INCOME.

(a) DEFINITION.— * * *

(b) ADJUSTMENTS TO TAXABLE INCOME.—For purposes of subsection (a), taxable income shall be adjusted as follows:

* * * * * * *

(9) DISTRIBUTIONS OF DIVESTED STOCK.—There shall be allowed as a deduction the amount of any dividend distribution received of divested stock (as defined in subsection (e) of section 1111), minus taxes imposed by this subtitle attributable to such receipt, but only if the stock with respect to which the distribution is made was owned by the distributee on September 6, 1961, or was owned by the distributee for at least 2 years prior to the date on which the antitrust order (as defined in subsection (d) of section 1111) was entered.

(10) SPECIAL ADJUSTMENT ON DISPOSITION OF ANTITRUST STOCK RECEIVED AS A DIVIDEND.—If—

(A) a corporation received antitrust stock (as defined in section 301(f)) in a distribution to which section 301 applied,

(B) the amount of the distribution determined under section 301(f)(2) exceeded the basis of the stock determined under section 301(f)(3), and

(C) paragraph (9) did not apply in respect of such distribution,

then proper adjustment shall be made, under regulations prescribed by the Secretary or his delegate, if such stock (or other property the basis of which is determined by reference to the basis of such stock) is sold or exchanged.

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SEC. 543. PERSONAL HOLDING COMPANY INCOME.

(a) GENERAL RULE.—For purposes of this subtitle, the term "personal holding company income" means the portion of the gross income which consists of:

(1) DIVIDENDS, ETC.—Dividends, interest, royalties (other than mineral, oil, or gas royalties or copyright royalties), and annuities. This paragraph shall not apply to interest constituting rent as defined in paragraph (7) or to interest on amounts set aside in a reserve fund under section 511 or 607 of the Merchant Marine Act, 1936. *This paragraph shall not apply to a dividend distribution of divested stock (as defined in subsection (e) of section 1111) but only if the stock with respect to which the distribution is made was owned by the distributee on September 6, 1961, or was owned by the distributee for at least 2 years prior to the date on which the antitrust order (as defined in subsection (d) of section 1111) was entered.*

(2) STOCK AND SECURITIES TRANSACTIONS.—Except in the case of regular dealers in stock or securities, gains from the sale or exchange of stock or securities.

* * * * * * *

(b) LIMITATION ON GROSS INCOME IN CERTAIN TRANSACTIONS.—For purposes of this part—

(1) gross income and personal holding company income determined with respect to transactions described in section 543(a)(2) (relating to gains from stock and security transactions) shall include only the excess of gains over losses from such transactions, and

(2) gross income and personal holding company income determined with respect to transactions described in section 543(a)(3) (relating to gains from commodity transactions) shall include only the excess of gains over losses from such transactions.

(c) GROSS INCOME OF INSURANCE COMPANIES OTHER THAN LIFE OR MUTUAL.—In the case of an insurance company other than life or mutual, the term "gross income" as used in this part means the gross income, as defined in section 832(b)(1), increased by the amount of losses incurred, as defined in section 832(b)(5), and the amount of expenses incurred, as defined in section 832(b)(6), and decreased by the amount deductible under section 832(c)(7) (relating to tax-free interest).

(d) SPECIAL ADJUSTMENT ON DISPOSITION OF ANTITRUST STOCK RECEIVED AS A DIVIDEND.—If—

(1) a corporation received antitrust stock (as defined in section 301(f)) in a distribution to which section 301 applied,

(2) the amount of the distribution determined under section 301(f)(2) exceeded the basis of the stock determined under section 301(f)(3), and

(3) such distribution was includible in personal holding company income under subsection (a)(1),

then proper adjustment shall be made, under regulations prescribed by the Secretary or his delegate, to amounts includible in personal holding company income under subsection (a)(2) with respect to such stock (or other property the basis of which is determined by reference to the basis of such stock).

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SEC. 545. UNDISTRIBUTED PERSONAL HOLDING COMPANY INCOME.

(a) DEFINITION.—For purposes of this part, the term "undistributed personal holding company income" means the taxable income of a personal holding company adjusted in the manner provided in subsection (b), minus the dividends paid deduction as defined in section 561.

(b) ADJUSTMENTS TO TAXABLE INCOME.—For the purposes of subsection (a), the taxable income shall be adjusted as follows:

* * * * * * *

(10) DISTRIBUTIONS OF DIVESTED STOCK.—There shall be allowed as a deduction the amount of any income attributable to the receipt of a distribution of divested stock (as defined in subsection (e) of section 1111), minus the taxes imposed by this subtitle attributable to such receipt, but only if the stock with respect to which the distribution is made was owned by the distributee on September 6, 1961, or was owned by the distributee for at least 2 years prior to the date on which the antitrust order (as defined in subsection (d) of section 1111) was entered.

(11) SPECIAL ADJUSTMENT ON DISPOSITION OF ANTITRUST STOCK RECEIVED AS A DIVIDEND.—If—

(A) a corporation received antitrust stock (as defined in section 301(f)) in a distribution to which section 301 applied,

(B) the amount of the distribution determined under section 301(f)(2) exceeded the basis of the stock determined under section 301 (f)(3), and

(C) paragraph (10) did not apply in respect of such distribution,

then proper adjustment shall be made, under regulations prescribed by the Secretary or his delegate, if such stock (or other property the basis of which is determined by reference to the basis of such stock) is sold or exchanged.

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SEC. 556. UNDISTRIBUTED FOREIGN PERSONAL HOLDING COMPANY INCOME.

(a) DEFINITION.—For purposes of this part, the term "undistributed foreign personal holding company income" means the taxable income of a foreign personal holding company adjusted in the manner provided in subsection (b), minus the dividends paid deduction (as defined in section 561).

(b) ADJUSTMENTS TO TAXABLE INCOME.—For the purposes of subsection (a), the taxable income shall be adjusted as follows:

* * * * * * *

(7) DISTRIBUTIONS OF DIVESTED STOCK.—There shall be allowed as a deduction the amount of any income attributable to the receipt of a distribution of divested stock (as defined in subsection (e) of section 1111), minus the taxes imposed by this subtitle attributable to such receipt, but only if the stock with respect to which the distribution is made was owned by the distributee on September 6, 1961, or was owned by the distributee for at least 2 years prior to the date on which the antitrust order (as defined in subsection (d) of section 1111) was entered.

(8) SPECIAL ADJUSTMENT ON DISPOSITION OF ANTITRUST STOCK RECEIVED AS A DIVIDEND.—If—

(A) a corporation received antitrust stock (as defined in section 301(f)) in a distribution to which section 301 applied,

(B) the amount of the distribution determined under section 301(f)(2) exceeded the basis of the stock determined under section 301(f)(3), and

(C) paragraph (7) did not apply in respect of such distribution,

then proper adjustment shall be made, under regulations prescribed by the Secretary or his delegate, if such stock (or other property the basis of which is determined by reference to the basis of such stock) is sold or exchanged.

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SEC. 561. DEFINITION OF DEDUCTION FOR DIVIDENDS PAID.

(a) GENERAL RULE.—The deduction for dividends paid shall be the sum of—

(1) the dividends paid during the taxable year,

(2) the consent dividends for the taxable year (determined under section 565), and

(3) in the case of a personal holding company, the dividend carryover described in section 564.

[(b) SPECIAL RULES APPLICABLE.—In determining the deduction for dividends paid, the rules provided in section 562 (relating to rules applicable in determining dividends eligible for dividends paid deduction) and section 563 (relating to dividends paid after the close of the taxable year) shall be applicable.]

(b) SPECIAL RULES APPLICABLE.—

(1) In determining the deduction for dividends paid, the rules provided in section 562 (relating to rules applicable in determining dividends eligible for dividends paid deduction) and section 563 (relating to dividends paid after the close of the taxable year) shall be applicable.

(2) If a corporation received antitrust stock (as defined in section 301(f)) in a distribution to which section 301 applied and such corporation distributes such stock (or other property the basis of which is determined by reference to the basis of such stock) to its shareholders, proper adjustment shall be made, under regulations prescribed by the Secretary or his delegate, to the amount of the deduction provided for in subsection (a).

Subchapter O—Gain or Loss on Disposition of Property

Part I. Determination of amount of and recognition of gain or loss.
Part II. Basis rules of general application.
Part III. Common nontaxable exchanges.
Part IV. Special rules.
Part V. Changes to effectuate FCC policy.
Part VI. Exchanges in obedience to SEC orders.
Part VII. Wash sales of stock or securities.
Part VIII. Distributions pursuant to Bank Holding Company Act of 1956.
Part IX. Distributions pursuant to orders enforcing the antitrust laws.

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PART IX—DISTRIBUTIONS PURSUANT TO ORDERS ENFORCING THE ANTITRUST LAWS

Sec. 1111. Distribution of stock pursuant to order enforcing the antitrust laws.

SEC. 1111. DISTRIBUTION OF STOCK PURSUANT TO ORDER ENFORCING THE ANTITRUST LAWS.

(a) GENERAL RULE.—Notwithstanding sections 301, 312, and 316, a distribution of divested stock (as defined in subsection (f)), to a qualifying shareholder (as defined in subsection (b)), to which section 301(c)(1) would, but for this section, apply, shall be a distribution which is not out of the earnings and profits of the distributing corporation for purposes of this subtitle.

(b) QUALIFYING SHAREHOLDER.—For purposes of this section, the term "qualifying shareholder" means any shareholder other than a corporation which may be allowed a deduction under section 243, 244, or 245 with respect to dividends received.

(c) SPECIAL RULES.—

(1) DISTRIBUTIONS TO AVOID FEDERAL INCOME TAX.—Subsection (a) shall not apply to any transaction one of the principal purposes of which is the distribution of the earnings and profits of the distributing corporation or of the corporation whose stock is distributed, or both.

(2) STOCK.—For purposes of this section, the term "stock" includes rights to fractional shares.

(d) DEFINITION OF ANTITRUST ORDER.—For purposes of this section, the term "antitrust order" means, in the case of any corporation, a final judgment rendered after January 1, 1961, by a court with respect to such corporation in a court proceeding under the Sherman Act (26 Stat. 209; 15 U.S.C. 1-7) or the Clayton Act (38 Stat. 730; 15 U.S.C. 12-27), or both, to which the United States is a party, if such proceeding was commenced on or before January 1, 1959.

(e) DEFINITION OF DIVESTED STOCK.—For purposes of this section, the term "divested stock" means stock meeting the following requirements:

(1) the stock is the subject of an antitrust order entered after January 1, 1961, which—

(A) directs the distributing corporation to divest itself of such stock by distributing it to its shareholders (or requires such distribution as an alternative to other action by any person);

(B) specifies and itemizes the stock to be divested; and

(C) fixes the period of time within which the distributing corporation must divest itself of all stock to be disposed of by it by reason of the suit, and such period expires not later than 3 years from the date on which such order becomes final (appeal time having run or appeal having been completed); and

(2) the court finds—

(A) that the divestiture of such stock, in the manner described in paragraph (1)(A), is necessary or appropriate to effectuate the policies of the Sherman Act, or the Clayton Act, or both;

(B) that the application of subsection (a) is required to reach an equitable antitrust order in such suit or proceeding; and

(C) that the period of time for the complete divestiture fixed in the order is the shortest period within which such divestiture can be executed with due regard to the circumstances of the particular case;

but no stock shall be divested stock if the court finds that its divestiture is required because of an intentional violation of the Sherman Act, or the Clayton Act, or both.

MINORITY VIEWS

INTRODUCTION

We are opposed to the Du Pont bill in its present form for a variety of reasons. These include the fact that—

(1) In the absence of a final court order, we are legislating in a partial vacuum. The tax and other consequences of the Du Pont divestiture of General Motors stock will not be known until there is a final court order, presumably late this fall or early next year.

(2) The priority for tax relief for the shareholders of General Motors and Du Pont, in view of the numerous tax loopholes and gross inequities in the present tax law, is about as low as for any group in the country. Although it has been impossible to move in both the House and the Senate on the tax reform proposals of the President, we find that a bill for the relief of those who are among the highest income groups in the country is treated with loving care and tender mercy by the committees of the Congress.

(3) The bill selects the most favored tax treatment for individual shareholders by treating the divestiture of General Motors stock to them as a "capital gain," and it also give the most favored tax treatment to corporations by treating the divestiture of General Motors stock to them as an "intercorporate dividend." There is a serious inconsistency here and the result could be a loss of from $110 to $140 million of revenue which the Government should properly receive.

TIMING

The haste with which the Congress is acting on this matter is not only unseemly and likely to be conducive of poor legislation, but also ill advised and unnecessary.

This bill, as it is now presented to the Senate, is, in form and in substance, a private relief bill. Ordinarily when a taxpayer comes before the Congress for relief the first information required of him is that he spell out the condition or hardship from which relief is sought. In this case the conditions have not yet been determined.

On September 1 of this year, Du Pont filed its proposed judgment of divestiture with the Chicago court. The Department of Justice has until October 2 to propose amendments. The court will then take the matter under advisement and decide what its final order is to be. Assuming the Chicago court acts with all possible speed and dispatch, an assumption not warranted by previous events. It is not likely that the final order would be entered before the first of November, perhaps much later.

The Supreme Court has decreed that divestiture must commence within 90 days of final judgment, which means that divestiture need not begin prior to February 1, 1962, or later. This will give the Congress ample time in which to act on a relief measure in January, provided a relief measure seems appropriate to mitigate whatever

harshness there may be in the court order. The Congress will then know definitely whether the relief it is granting is for the benefit of the Du Pont Co., Christiana, the Du Pont family, General Motors, or the individual stockholders of Du Pont and General Motors. It will, indeed, then know whether any relief at all is indicated, and, if so, what type of relief.

As matters now stand, this bill is for the relief of the Du Pont Co., as we shall later show.

It is, perhaps, even improper for the Congress to act at this time on any bill, since such action might well influence the final decree of the Chicago court. In our opinion the courts should be allowed to proceed on a case, once litigation has begun, without congressional interference. This litigation has now been before the courts for about 12 years and should be brought to an orderly conclusion. We cannot see that direct congressional interference at this time would be in keeping with the role which should properly be played, under the Constitution, by our branch of government. Indeed, congressional interference of this type would be no more appropriate than interference by the Executive.

PRIORITY

The Finance Committee ordinarily takes the position that tax measures must originate in the House. Time and again we have failed to hold hearings on important legislation or tax reform amendments to legislation on the grounds that the House has not acted or has not initiated the proposal.

This year when we urged Senate hearings on the President's tax reform proposals before the House had finished action, the committee refused to do so on this very ground.

In the case of the Du Pont bill, however, the Finance Committee held hearings before the House had finished its consideration of the bill. We wish to make it clear that we do not disapprove of this procedure. In fact, we applaud it. We are constrained to note, however, that it is not followed consistently, as pointed out above.

In the years we have served on the Finance Committee, we have never known the committee to hold an evening meeting. This year, however, members were notified at 3 minutes of 7 p.m. on September 20 than an executive session to consider this bill would be held at 8 p.m. We doubt very much that such swift action would be taken on a proposal to close a tax loophole or to give tax relief to the millions of people in this country who pay ordinary income tax and who are not in a position to take advantage of the numerous loopholes in the tax laws.

The Congress is therefore giving priority, both for tax relief and in the speed of its procedures, to a group whose need is not yet known and who, in any case, would have a very low priority for such relief compared with the ordinary taxpayer, in the light of the burdens which he must bear.

DEFECTS IN THE BILL

1. Is the divestiture of General Motors stock a capital transaction or is it a dividend?

There are some very serious defects in the bill. The Du Pont Co. will be required to divest its General Motors stock to both individual stockholders and corporate stockholders.

In the case of individual stockholders, if the divestiture is treated as an ordinary dividend the tax is relatively high, but if the divestiture is treated as a return of capital the tax is relatively low. Thus, with respect to individual stockholders, this bill treats the divestiture as a return of capital and thus requires that the lower tax be paid.

In the case of divestiture to corporations, if the divestiture is treated as an intercorporate dividend the tax is very low (i.e., 52 percent of 15 percent, or 7.8 percent), but if the divestiture is treated as a return of capital the tax is relatively high. Thus, in the case of divestiture to corporations, this bill chooses the method by which a lower tax is paid and treats the divestiture as a dividend.

In other words, with respect to the two classes who will receive General Motors stock from Du Pont, namely, individual stockholders and corporate stockholders, in each case the bill gives the most favored tax treatment to the recipient.

Our position is that this divestiture is either a capital transaction or it is a dividend. It cannot be both. It should not be a return of capital to the individual and a dividend to the corporation, nor should it be a dividend to the individual and a return of capital to the corporation. It should be one or the other, and the bill is highly inconsistent in this respect.

Needless to say, inconsistency in the bill gives the most favored tax treatment in each case. This inconsistency in treatment of individual stockholders on the one hand, and the corporate stockholders on the other, can have very serious consequences with respect to the public interest.

The Christiana Securities Co., which is in effect a family holding company, owns about 29 percent of the Du Pont stock. Hence, a proportionate share of the General Motors stock which is to be divested will go to Christiana. Under the bill this will be taxed as an intercorporate dividend, which, in this case, would be at the rate of 52 percent of 15 percent of the market value of the stock. Since the market value of the stock is about $45 this means that Christiana will pay a tax of approximately $3.50 per share because of this treatment. If, on the other hand, the divestitures of General Motors stock to Christiana and other corporations were treated as a capital gain—as the company and the bill argue is correct for the divestiture to individuals—the tax would be approximately $10.75 per share. In other words, there is a tax savings of about $7.25 per share for that portion of General Motors stock which is divested to corporations.

Unless a capital gains tax is paid, this will mean a loss in revenue to the Government, which we think rightly should be paid, and a gain to Christiana, of somewhere between $110 and $140 million.

This effect could be ameliorated if Christiana were required to divest itself of General Motors stock to its individual shareholders. But at this time Christiana is not before the court, there is no assurance that the court will order Christiana to divest itself of General Motors

stock, and the receipt by the public and the Treasury of some $110 to $140 million remains a very "iffy" question.

If this bill were amended to require that the divestiture of General Motors stock to Christiana be treated as a capital gain, the problem would be greatly lessened and justice would be served.

Then the tax effects essentially would be the same whether Christiana divested or did not divest itself of its General Motors stock, and the court would be free to pass a judgment and to enter a final order without even having to consider these tax consequences. It is for this reason that we believe that the bill, as a minimum, should be amended in either one of two ways, namely: (1) to require that the divestiture of General Motors stock by Du Pont to corporations be treated as a capital gain, or (2) to require that the provisions of the bill be inapplicable unless Christiana is directed to divest to its stockholders or to sell the General Motors stock which it will receive from Du Pont.

Christiana owns 29 percent of the Du Pont stock. The Du Pont family, very broadly defined, comprises some 250 individuals, who own about 69 percent of Christiana common stock, or 9,180,000 shares of the 13,248,640 shares of Christiana which are outstanding. While only a small number of these people have any direct business connection with either Du Pont or with Christiana Securities Co., it is true that if Christiana is not required to divest itself of the General Motors stock it will receive from Du Pont, the favorable tax consequences we have mentioned would accrue to these individuals in proportion to their holdings in Christiana.

2. Divestiture in lieu of dividends

Another possible consequence of the bill as written is that the Du Pont Co. might, in divesting itself of its General Motors stock, do so in lieu of paying its ordinary dividend. That is to say that instead of paying its ordinary dividend it would give its stockholders General Motors stock. The stockholder would then be in a position of paying a capital gains tax instead of the ordinary dividend tax on what really is ordinary dividend from the company.

The bill has a general provision to guard against this danger but it lacks any specific test. We therefore believe that an amendment is in order to provide that only those amounts which are in excess of the average dividend paid over the past 3 years should be allowed the capital gains treatment.

3. Partial liquidation

This bill is based on the theory that the General Motors stock to be distributed is a return, or partial return, of capital to Du Pont stockholders—at least this is true as to individual stockholders. In our view this is not the best approach, even among possible approaches in the capital transactions area.

The return of capital theory has a place in the tax laws, and indeed is firmly ensconced there. It often happens in the oil industry that, with highly artificial and artificially high depletion allowances, an oil company has no bookkeeping profits. It generates extremely large cash flows, but shows no earnings on its books. It will be in a position to return to investors most, or all, of their original investment, and still be a healthy and going concern. This money returned to stockholders is not classified as a dividend, however, because it is tech-

nically not out of earnings. In such a case, under existing law, the stockholder's basis is reduced, but he pays no income tax on a dividend. This gives a free ride to the stockholder, to the extent that his basis can be reduced to zero.

The Du Pont case does not fit this type of transaction. The distribution of General Motors stock to Du Pont stockholders is not a return of capital, but is, in reality, a distribution of a greatly appreciated capital asset in the form of a dividend. And, of course, under this bill it is still called a dividend as far as corporate stockholders are concerned, because such a classification will make their taxes lighter.

The facts of this situation more nearly fit the partial liquidation theory. The distribution of General Motors stock is a partial liquidation of the assets of Du Pont. Existing law recognizes this sort of transaction, and provides a capital gains tax treatment for it. The reason this type of tax cannot be applied under existing law in this case, however, is that existing law provides that, in order to get capital gains the distributing corporation must own at least 80 percent of the total assets of the corporation with respect to which distribution is made. The Du Pont case does not fit the 80 percent criterion since Du Pont does not own 80 percent of General Motors, but it fits, logically, this type of transaction.

It would seem to us that it would be much more logical to follow the partial liquidation theory in this transaction. Indeed, this was the recommendation of the Treasury in 1959. Under this theory, a capital gains tax would be paid by individual stockholders, just as in the current bill, but the basis for General Motors and Du Pont stock would be computed differently. Also, all stockholders, individual and corporate, would be treated alike.

One of the peculiarities of this bill, and one which is glossed over by its proponents, is the very artificial way in which the basis is computed for both the General Motors stock and the Du Pont stock in the hands of Du Pont stockholders following distribution of the General Motors stock. Under this bill, a great deal of the tax which ought to be paid under the capital gains theory is delayed by an artificial reduction of the basis of the Du Pont stock, and this basis may be reduced as low as zero.

Proponents of this measure will say that this portion of the tax is merely postponed. This is not so, particularly in the case of wealthy stockholders who regularly make use of foundations and other devices to reduce their tax.

We think it is also in order to point out the position in which this bill puts General Motors. By the artificial method used in allocating basis between Du Pont and General Motors stock, there will be a great deal of Du Pont stock which will have a zero, or close to zero, basis. This stock will be held off the market. It will not be sold, because to sell it would subject the seller to a high capital gains tax. The Du Pont stockholder who wants to sell anything will sell the General Motors stock which he will receive as a result of this divestiture because that stock will have a relatively high basis and, therefore, such a sale will subject him to a low capital gains tax.

Now, what does this mean for General Motors? It means that General Motors stock may very well have an uncertain market for years to come. The management of General Motors will be at a

decided disadvantage if they try to issue any new stock to raise equity capital. This bill, in our opinion, does no favors for General Motors; indeed, if this bill were as helpful to General Motors as has been claimed, it seems to us that the president of General Motors would have been before the Finance Committee to urge its passage. That company was content with filing a routine statement.

SHIFTING THE TAX BURDEN

Actually this bill has been, and is being, widely misinterpreted as a relief measure for the benefit of Du Pont stockholders. It is no such thing. It is a relief measure for the benefit of the Du Pont Co. and will result in shifting a tax from the company to the stockholders directly.

The president of Du Pont has testified before the Finance Committee to the effect that, under existing law, his company would follow a three-part plan of divestiture which would subject the stockholders of Du Pont to no taxes in excess of the normal tax on their dividends. Instead, this plan would subject the Du Pont Co. to a tax of somewhere between $123 and $350 million. This tax, of course, spread over a 10-year period, would hardly be confiscatory for a company which earned $787 million in 1960.

Under the terms of this bill, however, the tax burden would be shifted directly to, and squarely upon the shoulders of, the individual and corporate stockholders of the Du Pont Co. This bill is, therefore, not for the benefit of the stockholders, as such, but for the benefit of the company.

We will be ready in January to consider a bill to cover whatever situation develops as a result of the Court order, after such order has become final. At this time, we feel any bill is premature, and the bill now before the Senate, regardless of its possible merits or obvious defects, should not be enacted into law.

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ALBERT GORE.