Calendar No. 1175

88TH CONGRESS, 2d Session | SENATE | REPORT No. 1240

ACCRUED VACATION PAY; ESTATE TAXES; STUDY OF FEASIBILITY OF IMPOSING TAXES ON CERTAIN TRANSIENT AND COMMUTER SYSTEMS; CONSTRUCTIVE OWNERSHIP OF STOCK

JULY 24, 1964.—Ordered to be printed

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

REPORT

[To accompany H.R. 10467]

The Committee on Finance, to whom was referred the bill (H.R. 10467) to continue for a temporary period certain existing rules relating to the deductibility of accrued vacation pay, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

Your committee has accepted the provision contained in the House bill without change. However, it has added to the bill three amendments relating to other tax subjects.

I. SUMMARY OF BILL

H.R. 10467 as passed by the House provides that a deduction for accrued vacation pay is not to be denied for any taxable year ending before January 1, 1967, solely because the liability for it to a specific person has not been fixed or because the liability for it to each individual cannot be computed with reasonable accuracy. However, for the corporation to obtain the deduction, the employee must have performed the qualifying service necessary under a plan or policy which provides for vacations with pay to qualified employees and the plan or policy must have been communicated to the employees involved before the beginning of the vacation year. This is a continuation for 2 more years of the treatment which has been available for taxable years ending before January 1, 1965.

Your committee has accepted this provision without change.

In addition to the House-passed provision, the bill as reported by your committee contains three other amendments.

First, it provides that for purposes of the Federal estate tax, the taxable estate of Carbon P. Dubbs is to be determined by deducting from the gross estate (in addition to other deductions and exemptions otherwise allowable) the sum of $808,147.87 provided that cash in the amount of $779,699.17 and household furnishings and equipment with a fair market value of $28,448.70 are transferred within 60 days after the enactment of this bill to the U.S Department of State.

Second, the Secretary of Commerce, through the Bureau of Public Roads, is to investigate and study the feasibility of imposing taxes on transit and commuter systems which are the beneficiaries of Federal financial assistance under the Urban Mass Transportation Act of 1964, for the purpose of raising revenues to defray Federal expenditures under that act. The result of this investigation and study together with the recommendations of the Secretary of Commerce are to be reported to the Committee on Finance of the Senate and the Committee on Ways and Means of the House no later than June 30, 1965.

Third, the constructive ownership rules for stock for purposes of determining what is a dividend, as well as for certain other purposes, are amended to eliminate what is called the sidewise attribution rules. Under these sidewise attribution rules, for example, stock owned by a partner is treated as owned by the partnership and, in turn, other partners are treated as holding what the partnership is considered as holding. Substantially similar situations arise in the case of beneficiaries of a trust and shareholders in a corporation.

The Treasury Department has indicated that it does not object to the enactment of the provision passed by the House. With respect to the first of the committee amendments referred to above, the Treasury Department has been informed by the State Department and the Bureau of the Budget that the acquisition will be beneficial to the Government. Under these circumstances, the Treasury Department expressed the view that the advisability of legislation of this nature facilitating this method of acquisition is properly a question of congressional procedures and determination. With respect to the second committee amendment referred to above, the Treasury Department indicated that it would prefer that this study be conducted by the Housing and Home Finance Agency rather than through the Bureau of Public Roads. In addition, it believes that the proposed amendment is not consistent with the policy regarding the financing of net project costs established in section 4 of the Urban Mass Transportation Act of 1964. With respect to the third committee amendment referred to above, the Treasury Department indicates that it approves the objective of this provision and has no objection to its enactment.

DEDUCTIBILITY OF ACCRUED VACATION PAY

Under the 1939 code (sec. 43), the period of time for taking deductions was stated to be the taxable year in which the expenses were "paid or accrued" or "paid or incurred," depending upon the method of accounting, "unless in order to clearly reflect the income, the deductions or credits should be taken as of a different period." Under this provision, it was held that vacation pay for the next year could be accrued as of the close of the taxable year in which the qualifying

services were rendered. However, under the employment contract, all of the events necessary to fix the liability of the taxpayer for the vacation pay must have occurred by the close of the taxable year. In determing whether the events necessary to fix the liability of the taxpayer for vacation had occured, the fact that the employee's rights to a vacation (or payment in lieu of vacation) in the following year might be terminated if his employment ended before the scheduled period was not regarded as making the liability a contingent one (rather than a fixed one). It was held that the liability was not contingent since the employer could expect the employees as a group to receive the vacation pay and, therefore, that only the specific amount of the liability with respect to individuals remained uncertain at the close of the year (GCM 25261, C.B. 1947–2, 44; I.T. 3956, C.B. 1949–1, 78).

In 1954, Congress enacted section 462 of the 1954 code which provided for the deduction of additions to reserves for certain estimated expenses. With this provision in the Internal Revenue Code, it was thought that reserves for vacation pay generally would be covered, and, therefore, that it was no longer necessary to maintain the liberal administrative position described above with respect to vacation pay. As a result, in Revenue Ruling 54–608 (C.B. 1954–2, 8), the Internal Revenue Service revised its position on the deductibility of vacation pay. In this ruling, it held that no accrual of vacation pay could occur until the fact of liability with respect to specific employees was clearly established and the amount of the liability to each individual employee was capable of computation with reasonable accuracy. It was thought that taxpayers accruing vacation pay under plans which did not meet the requirements of the strict accrual rule set forth in this ruling would utilize section 462 of the 1954 code. This ruling was initially made applicable to taxable years ending on or after June 30, 1955.

Because section 462 of the code was repealed, the Treasury Department in a series of actions continued to postpone the effective date of Revenue Ruling 54–608 until January 1, 1959 (the last of these postponements was made in Revenue Ruling 57–325, C.B. 1957–2, 302, July 8, 1957). It stated that Revenue Ruling 54–608 was to be inapplicable to taxable years ending before January 1, 1959, and also that in cases involving an agreement with a labor union which was in effect on June 30, 1957, which expired after December 31, 1958, the ruling was to be applicable for the first time to taxable years ending on or after the 90th day following the date the labor agreement expired.

Congress, in the Technical Amendments Act of 1958, further postponed the effective date of Revenue Ruling 54–608 for 2 more years, making it inapplicable to taxable years ending before January 1, 1961. Subsequently, Congress in two additional acts (Public Law 86–496 and Public Law 88–153), still further postponed the effective date of Revenue Ruling 54–608. The first of these laws provided that this ruling was not to become effective with respect to deducations for accrued vacation pay for any taxable year ending before January 1, 1963, and the second law provided that this ruling was not to be effective for these deductions for any taxable year ending before January 1, 1965.

Both the House and your committee's versions of this bill postpone for 2 more years the effective date of Revenue Ruling 54–608. As a

result, deductions for accrued vacation pay will not be denied for any taxable year ending before January 1, 1967, solely by reason of the fact that the liability for the vacation pay to a specific person has not been clearly established or that the amount of the liability to each individual is not capable of computation with reasonable accuracy. This additional time is required so Congress will have further time to consider the problem of the deduction of accrued vacation pay and other similar accrual-type deductions prior to the application of this Revenue Ruling 54–608 which provides stringent rules in this area.

III. DEDUCTION IN COMPUTING TAXABLE ESTATE OF CARBON P. DUBBS

Mr. Carbon P. Dubbs who died on August 21, 1962, was a U.S. citizen and a resident of Bermuda. The will of Mr. Dubbs provided that:

> I give and bequeath to such charitable, religious, or educational institutions, societies, or purposes, as my executors may in writing designate, in accordance with list thereof to be filed in the court where this will is probated, within 6 months after my death, such sums as they shall direct, provided only that such bequests are then exempt from the Federal estate tax. I have full and complete confidence in the judgment and discretion of my executors in the selection of said institutions and the amount payable to them out of my estate.

Mr. Dubbs' estate included real property known as Chelston, a 14½-acre property, which had been his residence for 20 years. The property includes a substantial principal residence as well as several cottages and outbuildings. The State Department considers the property to be ideally situated and suited for use as a place of residence for the consul general and also for international diplomatic conferences. Presently, a residence is leased in Bermuda for the consul general at an annual rental of $7,200 a year and the State Department has been seeking an appropriation for the purchase of an appropriate residence there.

The executors of Mr. Dubbs' estate have expressed a willingness to contribute the Chelston property to the State Department as a residence for the consul general under the provision of Mr. Dubbs' will referred to above.

Under the present internal revenue laws, it is impossible to provide a charitable contribution deduction for the transfer of Chelston to the State Department in this case because the regulations in effect since 1917 (presently sec. 20.2055–2(b)) provide that no charitable contribution deduction is to be allowed upon the death of a decedent where it is—

> dependent upon the performance of some act or the happening of a precedent event in order that it might become effective * * * unless the possibility that the charitable transfer will not become effective is so remote as to be negligible.

Thus, the estate tax attaches to the transfer of property by the decedent and is determined by the facts as they exist at the time of

his death. As a result, to obtain a charitable contribution deduction, discretion cannot be left to the executors as to the amount to be transferred for charitable purposes.

In addition, present law provides that no charitable contribution deduction is to be allowed for the transfer of property not included in a decedent's gross estate. Chelston is foreign real estate, and, since Mr. Dubbs died before the effective date of the provision in the Revenue Act of 1962, which first included foreign real estate in the gross estate of a decedent, this property is not included in the decedent's gross estate. Therefore, no charitable contribution may be taken with respect to it.

The Chelston property, including the household furnishings, has been estimated to have a value of $808,147.87 (a real property value of $779,699.17 and a value of $28,448.70 for the household furnishings and equipment). Based upon information available, it appears that a charitable contribution deduction for the gift of this property to the State Department would result in a tax saving to the estate of approximately $491,500.

The State Department and the Bureau of the Budget believe that considering all of the factors involved, the transfer of the property to the State Department and the granting of a charitable contribution deduction to the estate in this case would be beneficial to the Government. Your committee is in accord with this opinion.

Therefore, your committee has amended this bill to provide that for purposes of the Federal estate tax, in computing the taxable estate of Carbon P. Dubbs, there is to be allowed a deduction (in addition to other deductions and exemptions allowed by the code) of $808,147.87 if cash in the amount of $779,699.17 and household furnishings and equipment with a fair market value of $28,448.70 are transferred within 60 days of the date of enactment of this bill to the U.S. State Department pursuant to, and in accordance with, an offer of bequest dated February 19, 1963, from the estate of Carbon P. Dubbs. The cash received in this case is to be used for the purchase of Chelston. This provision further provides that the deduction provided in this provision is to be treated for purposes of the tax laws as if it had been a charitable contribution made on August 21, 1962, and allowable as a deduction in computing the taxable estate.

IV. STUDY OF THE FEASIBILITY OF IMPOSING USER TAXES ON MASS TRANSIT SYSTEMS RECEIVING FEDERAL AID

When Congress made provision for a federally supported Interstate Highway System, it made the Federal highway program, in effect, self-supporting through provision for the highway trust fund. To support the highway expenditures to be made from this fund, Congress added a series of new taxes on highway users and allocated certain already existing highway user taxes to the trust fund. Thus, Congress gave assurance that highway users would pay the cost of Federal highway expenditures. Your committee is interested in determining the feasibility of similarly imposing taxes on transit and commuter system users to the extent of Federal financial assistance under the Urban Mass Transportation Act of 1964.

Since the Bureau of Public Roads in the Commerce Department was instrumental in helping Congress devise suitable highway user

taxes, your committee in this provision is requesting that this same Bureau investigate and study the feasibility of imposing user taxes on transit and commuter systems to recover Federal expenditures under that act from the users of these systems.

In making this investigation and study, the Secretary of Commerce is authorized to cooperate and consult with appropriate Federal, State, and local governmental agencies and with representatives of the transit and commuter services industry and national organizations concerned with mass transportation service. The cost of the investigation and study is to be paid from appropriations available for expenses of the Office of the Secretary of Commerce.

The Secretary of Commerce under this provision is to report the results of the investigation and study together with his recommendations to the Committee on Finance of the Senate and the Committee on Ways and Means of the House at the earliest practicable date but in any event not later than June 30, 1965.

V. ELIMINATION OF "SIDEWISE" ATTRIBUTION RULES

When a corporation redeems part of a shareholder's stock, in many circumstances, this redemption is treated as the distribution of a dividend. However, where all of a shareholder's stock is redeemed the amount received generally is treated as a distribution in exchange for the stock, gain or loss being determined by reference to the cost (or other basis) for the stock surrendered. In the past a taxpayer occasionally attempted to avoid the dividend rule referred to above by retaining his own holdings of stock but having all of the stock redeemed which was held by a close member of his family or from a partnership, estate, trust, or corporation in which he had a substantial interest. Alternatively, the rule was avoided by having all of his own stock redeemed, but providing for the retention of stock held by a partnership, estate, trust, or corporation in which he had a substantial interest or by a close member of his family.

To forestall such tax avoidance, the 1954 code contains certain stock "attribution" rules wherein stock held by a close family member, or by a partnership, estate, trust, or corporation in which he has an interest, is attributed to the person in question in determining whether a distribution from a corporation is in partial or complete liquidation of his interest in the corporation. These attribution rules (contained in sec. 318 of the code) not only are applicable in determining whether a stock redemption is to be treated as a dividend or as an exchange for stock (sec. 302) but also apply to numerous other situations as well. However, in these other cases, the applicability of the rules vary somewhat.

In the case of a stock redemption they provide that stock owned by, or for, a partnership, trust or estate or corporation (in the case of a corporation, however, only if the person has a 50-percent or greater stock interest) is to be considered as owned proportionately (pro rata, according to their interest) by the partners, beneficiaries or shareholders. This is what might be called a "beneficial ownership" rule. In addition, stock owned by or for a partner or beneficiary or shareholder (again, in this latter case only if 50 percent or more of the stock is owned by the person) is considered for purposes of the dividend rule previously referred to as being owned by the partnership,

estate, or corporation. This, in effect, is what might be considered an "agency attribution" rule.

The operation of these two attribution rules together means, for example, that stock of a corporation held by a partner is considered to be stock held by any partnership of which he is a member (agency rule). This stock, which is considered to be held by the partnership, is then attributed (to the extent of his interest) to any other partner in the partnership (beneficial ownership rule). This double application of these rules has become known as sidewise attribution. Similar sidewise attributions occur in the case of beneficiaries of a trust or estate and also, to a lesser extent, in the case of shareholders of the same corporation. Situations of this latter type are relatively rare, however, because the attribution rules occur only where there is a 50-percent ownership by an individual. (This, the double attribution, occurs only where there is a 50–50 ownership by two persons.)

This double, or sidewise, attribution has the effect of attributing one person's stockholding to another even though there is neither an economic nor a family connection between the two persons. The effect of this sidewise attribution often is that a redeeming shareholder has 100 percent of the stock attributed to him and in no event will he be able to meet the requirements of the statutory provisions making it clear that the redemption is not a dividend.

The following example illustrates this problem: Assume that A, an individual, is a beneficiary of an estate and has a 20-percent interest in it. Assume also that B, another individual (not related to A), is entitled to the remaining 80-percent interest in the estate. Assume further that A and B both own stock in corporation X, A owning 65 of the outstanding 110 shares while B owns 10 (the remaining 35 shares being owned by persons not related to A or B or the estate). In this case, assume that the corporation redeems all of B's 10 shares. Under existing law, this is neither "substantially disproportionate" (under sec. 302(b)(2)) nor a "termination of a shareholder's interest" (under sec. 302(b)(3)). This is because beneficiary A's 65 shares are attributed to the estate and 80 percent of these 65 shares (52 shares) are then treated as owned by the other beneficiary, B. As a result, after the redemption B is still treated as owning 52 out of the 100 shares then outstanding, even though his own entire holding has been redeemed.

Your committee concluded, since there is no basis either in family relationship or in common economic interest for the application of these two attribution rules at the same time, that sidewise attribution should be eliminated from the constructive ownership rules of present law. This is in accord with numerous recommendations of technical advisory groups which have concerned themselves with this problem.

Your committee's amendment eliminates this sidewise attribution by providing that when stock is attributed to a partnership, estate, trust, or corporation from a partner, shareholder, or beneficiary (agency rule), this stock is not again to be attributed to another partner, beneficiary, or shareholder under the second (beneficial ownership) rule. This is the only substantive change made in these rules.

The amendments made by this provision are to take effect as of the date of enactment of this bill except that these amendments are not to apply (for purposes of secs. 302 and 304 of the code) to dis-

tributions in payment for stock, acquisitions, or redemptions if these acquisitions or redemptions occurred before the date of enactment of this bill.

V. 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):

SECTION 97 OF THE TECHNICAL AMENDMENTS ACT OF 1958

(26 U.S.C., sec. 162 note)

SEC. 97. DEDUCTIBILITY OF ACCRUED VACATION PAY.

Deduction under section 162 of the Internal Revenue Code of 1954 for accrued vacation pay, computed in accordance with the method of accounting consistently followed by the taxpayer in arriving at such deduction, shall not be denied for any taxable year ending before January 1, [1965] *1967*, solely by reason of the fact that (1) the liability for the vacation pay to a specific person has not been clearly established, or (2) the amount of the liability to each individual is not capable of computation with reasonable accuracy, if at the time of the accrual the employee in respect of whom the vacation pay is accrued has performed the qualifying service necessary under a plan or policy (communicated to the employee before the beginning of the vacation year) which provides for vacations with pay to qualified employees.

* * * * * * *

INTERNAL REVENUE CODE OF 1954

SEC. 318. CONSTRUCTIVE OWNERSHIP OF STOCK.

(a) GENERAL RULE.—For purposes of those provisions of this subchapter to which the rules contained in this section are expressly made applicable—

(1) MEMBERS OF FAMILY.—

(A) IN GENERAL.—An individual shall be considered as owning the stock owned, directly or indirectly, by or for—

(i) his spouse (other than a spouse who is legally separated from the individual under a decree of divorce or separate maintenance), and

(ii) his children, grandchildren, and parents.

(B) EFFECT OF ADOPTION.—For purposes of subparagraph (A) (ii), a legally adopted child of an individual shall be treated as a child of such individual by blood.

[(2) PARTNERSHIPS, ESTATES, TRUSTS, AND CORPORATIONS.—

[(A) PARTNERSHIPS AND ESTATES.—Stock owned, directly or indirectly, by or for a partnership or estate shall be considered as being owned proportionately by its partners or beneficiaries. Stock owned, directly or indirectly, by or for a partner or a beneficiary of an estate shall be considered as being owned by the partnership or estate.

[(B) TRUSTS.—Stock owned, directly or indirectly, by or for a trust shall be considered as being owned by its beneficiaries in

proportion to the actuarial interest of such beneficiaries in such trust. Stock owned, directly or indirectly, by or for a beneficiary of a trust shall be considered as being owned by the trust, unless such beneficiary's interest in the trust is a remote contingent interest. For purposes of the preceding sentence, a contingent interest of a beneficiary in a trust shall be considered remote if, under the maximum exercise of discretion by the trustee in favor of such beneficiary, the value of such interest, computed actuarially, is 5 percent or less of the value of the trust property. Stock owned, directly or indirectly, by or for any portion of a trust of which a person is considered the owner under subpart E of part I of subchapter J (relating to grantors and others treated as substantial owners) shall be considered as being owned by such person; and such trust shall be treated as owning the stock owned, directly or indirectly, by or for that person. This subparagraph shall not apply with respect to any employees' trust described in section 401(a) which is exempt from tax under section 501(a).

[(C) CORPORATIONS.—If 50 percent or more in value of the stock in a corporation is owned, directly or indirectly, by or for any person, then—

[(i) such person shall be considered as owning the stock owned, directly or indirectly, by or for that corporation, in that proportion which the value of the stock which such person so owns bears to the value of all the stock in such corporation; and

[(ii) such corporation shall be considered as owning the stock owned, directly or indirectly, by or for that person.]

[(2) OPTIONS.—If any person has an option to acquire stock, such stock shall be considered as owned by such person. For purposes of this paragraph, an option to acquire such an option, and each one of a series of such options, shall be considered as an option to acquire such stock.

[(4) CONSTRUCTIVE OWNERSHIP AS ACTUAL OWNERSHIP.—

[(A) IN GENERAL.—Except as provided in subparagraph (B), stock constructively owned by a person by reason of the application of paragraph (1), (2), or (3) shall, for purposes of applying paragraph (1), (2), or (3), be treated as actually owned by such person.

[(B) MEMBERS OF FAMILY.—Stock constructively owned by an individual by reason of the application of paragraph (1) shall not be treated as owned by him for purposes of again applying paragraph (1) in order to make another the constructive owner of such stock.

[(C) OPTION RULE IN LIEU OF FAMILY RULE.—For purposes of this paragraph, if stock may be considered as owned by an individual under paragraph (1) or (3), it shall be considered as owned by him under paragraph (3).]

(2) ATTRIBUTION FROM PARTNERSHIPS, ESTATES, TRUSTS, AND CORPORATIONS.—

(A) FROM PARTNERSHIPS AND ESTATES.—Stock owned, directly or indirectly, by or for a partnership or estate shall be considered as owned proportionately by its partners or beneficiaries.

(B) FROM TRUSTS.—

(i) Stock owned, directly or indirectly, by or for a trust (other than an employees' trust described in section 401(a) which is exempt from tax under section 501(a)) shall be considered as owned by its beneficiaries in proportion to the actuarial interest of such beneficiaries in such trust.

(ii) Stock owned, directly or indirectly, by or for any portion of a trust of which a person is considered the owner under subpart E of part I of subchapter J (relating to grantors and others treated as substantial owners) shall be considered as owned by such person.

(C) FROM CORPORATIONS.—If 50 percent or more in value of the stock in a corporation is owned, directly or indirectly, by or for any person, such person shall be considered as owning the stock owned, directly or indirectly, by or for such corporation, in that proportion which the value of the stock which such person so owns bears to the value of all the stock in such corporation.

(3) ATTRIBUTION TO PARTNERSHIPS, ESTATES, TRUSTS, AND CORPORATIONS.—

(A) TO PARTNERSHIPS AND ESTATES.—Stock owned, directly or indirectly, by or for a partner or a beneficiary of an estate shall be considered as owned by the partnership or estate.

(B) TO TRUSTS.—

(i) Stock owned, directly or indirectly, by or for a beneficiary of a trust (other than an employees' trust described in section 401(a) which is exempt from tax under section 501(a)) shall be considered as owned by the trust, unless such beneficiary's interest in the trust is a remote contingent interest. For purposes of this clause, a contingent interest of a beneficiary in a trust shall be considered remote if, under the maximum excise of discretion by the trustee in favor of such beneficiary, the value of such interest, computed actuarially, is 5 percent or less of the value of the trust property.

(ii) Stock owned, directly or indirectly, by or for a person who is considered the owner of any portion of a trust under subpart E of part I of subchapter J (relating to grantors and others treated as substantial owners) shall be considered as owned by the trust.

(C) TO CORPORATIONS.—If 50 percent or more in value of the stock in a corporation is owned, directly or indirectly, by or for any person, such corporation shall be considered as owning the stock owned, directly or indirectly, by or for such person.

(4) OPTIONS.—If any person has an option to acquire stock, such stock shall be considered as owned by such person. For purposes of this paragraph, an option to acquire such an option, and each one of a series of such options, shall be considered as an option to acquire such stock.

(5) OPERATING RULES.—

(A) IN GENERAL.—Except as provided in subparagraphs (B) and (C), stock constructively owned by a person by reason of the application of paragraph (1), (2), (3), or (4), shall, for purposes of applying paragraphs (1), (2), (3), and (4), be considered as actually owned by such person.

(B) MEMBERS OF FAMILY.—Stock constructively owned by an individual by reason of the application of paragraph (1) shall not be considered as owned by him for purposes of again applying paragraph (1) in order to make another the constructive owner of such stock.

(C) PARTNERSHIPS, ESTATES, TRUSTS, AND CORPORATIONS.—Stock constructively owned by a partnership, estate, trust, or corporation by reason of the application of paragraph (3) shall not be considered as owned by it for purposes of applying paragraph (2) in order to make another the constructive owner of such stock.

(D) OPTION RULE IN LIEU OF FAMILY RULE.—For purposes of this paragraph, if stock may be considered as owned by an individual under paragraph (1) or (4), it shall be considered as owned by him under paragraph (4).