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REFUND OF TAXES ON EXPORTATION OF IMPORTED DISTILLED SPIRITS, WINES, AND BEER; REVOLVING CREDIT

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

REPORT

[To accompany H.R. 98]

The Committee on Finance, to whom was referred the bill (H.R. 98) to amend the Internal Revenue Code of 1954 with respect to exportation of imported distilled spirits, wines, and beer, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

I. SUMMARY

Your committee has accepted the House-passed provision without change. It has, however, added a new amendment relating to another tax matter.

H.R. 98, as passed by the House, provides for the refund or credit of the internal revenue taxes paid or determined with respect to distilled spirits, wines, or beer which have been imported into the United States where three conditions exist: (1) the alcoholic beverage has been found to be unmerchantable or not to conform to sample or specifications; (2) the beverage has been returned to customs custody within 6 months; and (3) the beverage has been exported or destroyed in customs custody. Substantially similar treatment is already available in the case of domestic distilled spirits, wines, and beer.

The amendment added by your committee is concerned with installment method reporting for tax purposes. First, it provides that certain interest, carrying charges, or time price differentials are to be considered as a part of the contract price and reported for tax purposes on the installment basis. Secondly, it repeals the provision relating to revolving credit type plans adopted in the Revenue Act

of 1964, and restores the regulations previously in effect with respect to revolving credit.

The Treasury Department has indicated that it has no objection to the House-passed provision and favors the adoption of the amendment made by your committee.

II. REFUNDS OF TAX ON CERTAIN IMPORTED ALCOHOLIC BEVERAGES

Present law.—Most excise taxes are levied on the sale of a product, and if the sale is rescinded, a credit or refund of the excise taxes is available to the manufacturer or importer. Alcoholic beverage taxes, however, generally are imposed when the beverages are produced or imported rather than at the time sold.

In the case of domestic distilled spirits, wines, and beer removed from the bonded premises and for commercial reasons returned to these premises or destroyed, present law generally provides for a refunding, crediting, or abatement of the tax. Distilled spirits withdrawn from bonded premises in bulk containers on payment or determination of tax and found "unsuitable for the purpose for which intended to be used" may be returned to bonded premises in the original containers within 6 months of withdrawal, and the tax paid or determined is abated, remitted, credited, or refunded (secs. 5008(d) and 5215). Wine produced in the United States and found to be "unmerchantable" after release from bond may be returned to bond, and the taxes paid or determined are refunded, credited, or abated (secs. 5044 and 5361). Taxes paid by brewers of beer produced in the United States may be refunded or credited if the beer is removed from the market and is returned to the brewery or destroyed under supervision (sec. 5056).

Reasons for provision.—There is no comparable provision for crediting or refunding internal revenue taxes in the case of imported alcoholic beverages. In the case of distilled spirits and wine, it is possible under existing law to achieve this result by an indirect method. This involves the transfer of the distilled spirits or wine to a rectifying plant where they are subjected to a manufacturing process and then removed from the plant in bottles or packages for export. In such a case, the drawback provisions of present law (sec. 5062(b)) provide for a refund of the tax. This process, however, involves needless extra expense for the importer.

Explanation of bill.—To remove this discrimination against imported alcoholic beverages which have been found after entry not to be suitable for certain uses, H.R. 98 provides for refund or credit of the tax. The refund or credit is to be available in the case of imported distilled spirits, wines, and beer where these beverages (1) have been found to be "unmerchantable or not to conform to sample or specifications"; (2) have been returned to customs custody within 6 months; and (3) have been exported or destroyed under customs supervision.

Effective date.—This provision will apply with respect to articles exported or destroyed after the date of enactment of this bill where the conditions specified above have all been met.

Revenue effect.—It is anticipated that this provision will result in a negligible loss of revenue.

III. TREATMENT OF TIME PRICE DIFFERENTIALS AND REVOLVING CREDIT PLANS UNDER THE INSTALLMENT METHOD

The amendments made by your committee make two modifications in the section of present law (sec. 453) dealing with the installment method of reporting income for tax purposes. The first of these modifications is concerned with the treatment of so-called time price differentials and the second with so-called revolving credit type plans.

Time price differentials.—Present law (sec. 453(a)) provides that persons who regularly sell personal property on the installment plan may return as income from these sales in any year the proportion which the installment payments received in that year bear to the total contract price involved. Thus, a taxpayer using the installment method can defer reporting income for tax purposes until payments are received under the contract (rather than treating the entire amount as income as of the time the sale is made). This provides the seller with funds with which to pay the tax.

The long-standing practice of the Internal Revenue Service (recently confirmed in Rev. Rul. 64–126) has been to include in the "total contract price" so-called carrying charges (or time price differentials) "determined at the time of each installment sale and added to the established cash selling price as part of the 'total contract price' of the articles sold".

Thus, it is clear under present law that a carrying charge, or interest, determined with respect to *each* sale and added to the contract price of the article is a part of the price of the article being purchased and, therefore, that any income attributable to this carrying charge can be reported for tax purposes on a pro rata basis as the installment payments are received. It is understood, however, that the determination of whether the carrying charge is determined at the time of the sale of each article and added to the established cash selling price, may depend upon the taxpayer's billing practice rather than the method under which these charges are treated on the taxpayer's books and reports to its stockholders.

Your committee has concluded that this is a superficial distinction which should not be followed in determining the tax treatment of these carrying charges, or time price differentials. In this type of a situation, your committee has concluded that the "total contract price" should include amounts which a traditional installment seller treats on its books at the time of sale as a time price differential representing a part of the sales price, even though for customer billing purposes the amounts are treated as monthly service charges rather than being added to the selling price in a lump sum.

The provision added by your committee therefore provides that the total contract price of sales of personal property under the installment plan include carrying charges, or interest, determined with respect to these sales and added on the books of account of the seller to the established selling price of the property. Your committee has provided, however, that this is not to apply to sales of personal property under a revolving credit type plan. The revolving credit type plans here referred to are those described by the Treasury Department in its regulations issued on October 15, 1963 (T.D. 6682). It

also is not to apply to sales of real property or to casual sales of personal property (covered by sec. 453(b)).

The effect of including time price differentials in the total contract price is that, to the extent they ultimately reflect income to the taxpayer concerned, they are reported ratably as the installment payments are received rather than being reported on an accrual basis as the carrying charge, or interest, is earned.

In specifying that the carrying charges, or interest, must be added to the established cash selling price to the books of account of the seller, it is intended that these additions to the books of account be made on more than an annual basis, although not necessarily on a daily basis as the sales occur. It is expected that in the usual case this recording will be made at least on a monthly basis with respect to the entire time price differential for the sales of a given month, usually as sales for the month are posted. It is important to note that it is not required that the recording be on an individual customer basis.

The following example illustrates a time price differential which previously might not have qualified but which it is intended will qualify as a part of the total contract price upon the enactment of this provision. Assume that a corporation makes sales on the traditional installment plan under which customers agree to pay for each sale in installments. Assume further that each order blank reflects the terms of the sale and specifies that the total price consists of a cash price plus a "time price differential" of 1½ percent per month on the outstanding balance in the customer's account. Assume further that on its books and for purposes of reporting to stockholders, the corporation consistently makes the following entries each month when it records its sales: It makes a debit entry to accounts receivable and credit entries to its sales account and to a reserve account for collection expense, of the total price (including a fixed amount representing the time price differential). Under the committee's amendment in this case, the "total contract price" for purposes of the installment method includes this fixed "time price differential."

Revolving credit-type plans.—Prior to October 15, 1963, sales under revolving credit type plans were not recognized by the Treasury Department as installment sales for tax purposes because of certain differences between revolving credit plans and traditional installment plans.

Traditional installment plans (described in regulations sec. 1.453–2 (b)(1)) ordinarily involve a separate contract for each item of property purchased, providing for a series of payments specifically applicable to the purchase price of that property. Usually the seller also retains some type of security interest in the property until the property is paid for. Revolving credit type plans (described in regulations sec. 1.453–2(b)(2)) on the other hand usually do not involve separate sales contracts. Under these plans, any item in the store may be charged to the same account and the seller does not retain any security interest in the property sold. The buyer frequently has the option to pay his account in full within 30 days with no finance charges or he may pay the account in installments with periodic finance charges related to the unpaid balances of the account. In this latter case, the buyer's regular payments are not specifically attributable to the purchase price of any single item but instead go to reduce the unpaid balance on what may be the total price of several items purchased at different times.

New regulations were issued by the Treasury Department on October 15, 1963 (T.D. 6682) specifically providing for installment sale treatment of certain amounts received under revolving credit plans. Broadly speaking, under these rules, a sample of revolving credit sales is taken from balances in customer accounts as of the billing dates for the last month of the seller's taxable year and the percentage of sales in the sample accounts determined which: (1) are the type the revolving credit plan contemplates will be paid for in two or more installments and (2) actually are paid for in two or more installments. The percentage is then applied to the balance of the total revolving credit accounts (after adjusting for sales of non-personal property) and the resulting amount is treated as representing sales under the installment plan.

In the Revenue Act of 1964, Congress in effect replaced these regulations with a provision providing that the term installment plan was to include a revolving credit type plan, except that the term was not to include any such plan with respect to a purchaser who uses it primarily as an ordinary charge account.

Your committee has concluded that it would have been better to have left the Treasury Department with the opportunity to determine by regulation the extent to which sales under revolving credit type plans are to be treated as sales under installment plans. For that reason, it has repealed the provision added in this respect by the Revenue Act of 1964 (subsec. (e) of sec. 453 as added by sec. 222 of the Revenue Act of 1964). In taking this action, your committee intends that the term "sales on the installment plan" be interpreted by the regulations as covering "sales on a revolving credit type plan" to the full extent provided in the regulations issued by the Treasury Department on October 15, 1963 (T.D. 6682). However, it is anticipated that continuing efforts will be made to simplify the sampling procedures required by those regulations as experience makes this possible.

Effective dates.—The amendments made by your committee with respect to time-price differentials (sec. 3(a) of the bill) are to apply in respect of sales made in taxable years beginning on or after January 1, 1960.

The amendment specifying in the code the extent to which the revolving credit type plans are to be treated as installment plans (sec. 3(b) of the bill) is repealed in respect of sales made in taxable years beginning after December 31, 1963. This repeals this provision as of its initial effective date in the Revenue Act of 1964. The intent in this respect is to restore the regulations relating to revolving credit plans promulgated in T.D. 6682, on October 15, 1963, as if the provision had not been included in the code by the Revenue Act of 1964.

Revenue effect.—This provision is expected to result in a net one-time revenue gain of $90 million and subsequent annual gains of $4 million. This is composed of an estimated one-time revenue loss of up to $10 million, and annual losses of $1 million, from the time price differential amendment. The net gain also includes a one-time revenue gain of about $100 million, and subsequent annual gains of about $5 million, attributable to the repeal of the provision in present law relating to revolving credit-type plans.

IV. 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 453 OF THE INTERNAL REVENUE CODE OF 1954

SEC. 453. INSTALLMENT METHOD.

[(a) DEALERS IN PERSONAL PROPERTY.—Under regulations prescribed by the Secretary or his delegate, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit, realized or to be realized when payment is completed, bears to the total contract price.]

(a) DEALERS IN PERSONAL PROPERTY.—

(1) IN GENERAL.—Under regulations prescribed by the Secretary or his delegate, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit, realized or to be realized when payment is completed, bears to the total contract price.

(2) TOTAL CONTRACT PRICE.—For purposes of paragraph (1), the total contract price of all sales of personal property on the installment plan includes the amount of carrying charges or interest which is determined with respect to such sales and is added on the books of account of the seller to the established cash selling price of such property. This paragraph shall not apply with respect to sales of personal property under a revolving credit type plan or with respect to sales or other dispositions of property the income from which is, under subsection (b), returned on the basis and in the manner prescribed in paragraph (1).

(b) SALES OF REALTY AND CASUAL SALES OF PERSONALTY.—

(1) GENERAL RULE.—Income from—

(A) a sale or other disposition of real property, or

(B) a casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year) for a price exceeding $1,000,

may (under regulations prescribed by the Secretary or his delegate) be returned on the basis and in the manner prescribed in subsection (a).

(2) LIMITATION.—Paragraph (1) shall apply—

(A) In the case of a sale or other disposition during a taxable year beginning after December 31, 1953 (whether or not such taxable year ends after the date of enactment of this title), only if in the taxable year of the sale or other disposition—

(i) there are no payments, or

(ii) the payments (exclusive of evidences of indebtedness of the purchaser) do not exceed 30 per cent of the selling price.

(B) In the case of a sale or other disposition during a taxable year beginning before January 1, 1954, only if the income was (by reason of section 44 (b) of the Internal Revenue Code of 1939) returnable on the basis and in the manner prescribed in section 44 (a) of such code.

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[(e) REVOLVING CREDIT TYPE PLANS.—For purposes of subsection (a), the term "installment plan" includes a revolving credit type plan which provides that the purchaser of personal property at retail may pay for such property in a series of periodic payments of an agreed portion of the amounts due the seller under the plan, except that such term does not include any such plan with respect to a purchaser who uses his account primarily as an ordinary charge account.]

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SECTION 5062 OF THE INTERNAL REVENUE CODE OF 1954

SEC. 5062. REFUND AND DRAWBACK IN CASE OF EXPORTATION.

(a) REFUND.—Under such regulations as the Secretary or his delegate may prescribe, the amount of any internal revenue tax erroneously or illegally collected in respect to exported articles may be refunded to the exporter of the article, instead of to the manufacturer, if the manufacturer waives any claim for the amount so to be refunded.

(b) DRAWBACK.—On the exportation of distilled spirits or wines manufactured or produced in the United States on which an internal revenue tax has been paid or determined, and which are contained in any cask or package, or in bottles packed in cases or other containers, there shall be allowed, under regulations prescribed by the Secretary or his delegate, a drawback equal in amount to the tax found to have been paid or determined on such distilled spirits or wines. The preceding sentence shall not apply unless such distilled spirits have been packaged or bottled especially for export, or, in the case of distilled spirits originally bottled for domestic use, have been restamped and marked especially for export at the distilled spirits plant where originally bottled and before removal therefrom, under regulations prescribed by the Secretary or his delegate. The Secretary or his delegate is authorized to prescribe regulations governing the determination and payment or crediting of drawback of internal revenue tax on domestic distilled spirits and wines, including the requirement of such notices, bonds, bills of lading, and other evidence indicating payment or determination of tax and exportation as shall be deemed necessary.

(c) *EXPORTATION OF IMPORTED LIQUORS.*—

(1) ALLOWANCE OF TAX.—Upon the exportation of imported distilled spirits, wines, and beer upon which the duties and internal revenue taxes have been paid or determined incident to their importation into the United States, and which have been found after entry to be unmerchantable or not to conform to sample or specifications, and which have been returned to customs custody within six months

of their release therefrom, the Secretary or his delegate shall, under such regulations as he shall prescribe, refund, remit, abate, or credit without interest, to the importer thereof, the full amount of the internal revenue taxes paid or determined with respect to such distilled spirits, wines, or beer.

(2) DESTRUCTION IN LIEU OF EXPORTATION.—At the option of the importer, such imported distilled spirits, wines, and beer, after return to customs custody, may be destroyed under customs supervision and the importer thereof granted relief in the same manner and to the same extent as provided in this subsection upon exportation.

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