[COMMITTEE PRINT]

COMMITTEE ON FINANCE
UNITED STATES SENATE
RUSSELL B. LONG, *Chairman*

SUMMARY OF MINOR HOUSE-PASSED BILLS

PENDING BEFORE THE

COMMITTEE ON FINANCE

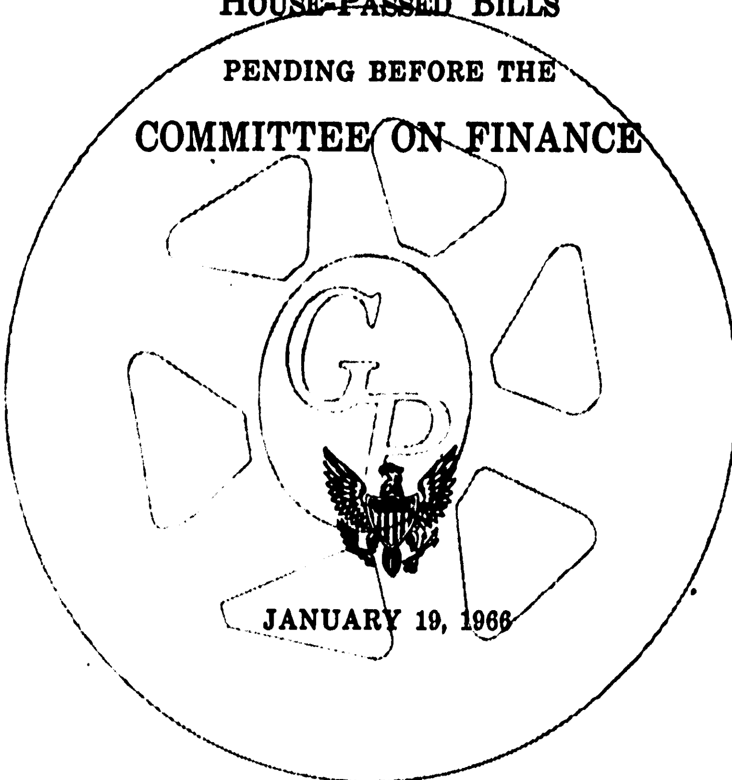

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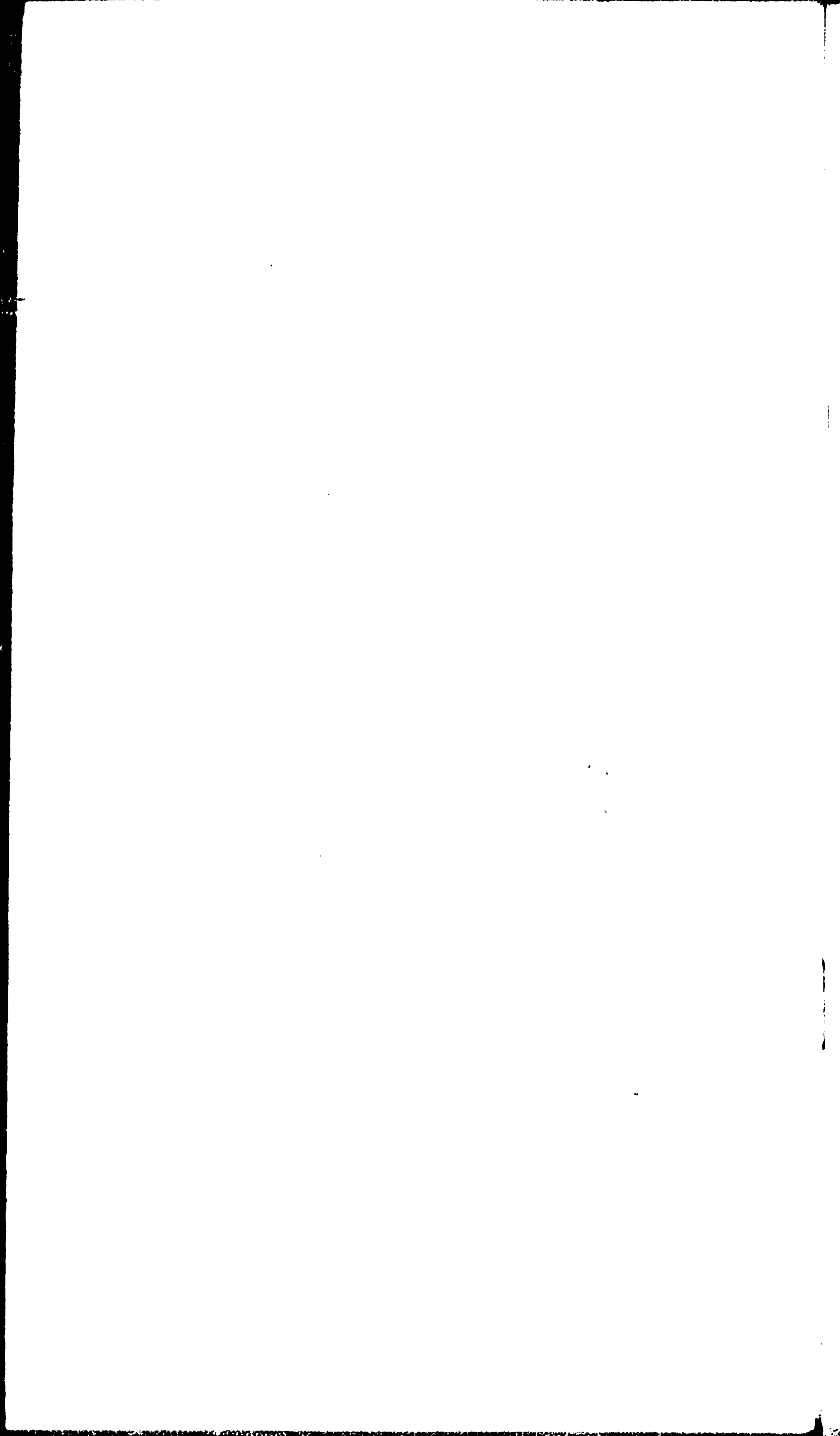
TABLE OF CONTENTS

		Page
1.	H.R. 318—Imposition of tire tax on tires delivered to manufacturers' retail outlet	1
2.	H.R. 327—Organizations providing funds for tax-exempt savings institutions	1
3.	H.R. 6319—Tax treatment of expropriation loss recoveries	2
4.	H.R. 6568—Coconut oil	3
5.	H.R. 7502—Casualty losses attributable to major disasters	4
6.	H.R. 7723—Suspension of duty on certain tropical hardwood	9
7.	H.R. 8210—European Space Research Organization	10
8.	H.R. 8436—Watch movements from insular possessions	11
9.	H.R. 8445—Retired pay of judges of the Tax Court	12
10.	H.R. 10625—Treatment of certain amounts paid to servicemen and their survivors	12
11.	H.R. 11029—Certain woven fabrics	13
12.	H.R. 11216—Articles assembled abroad	14
13.	H.R. 136 and H.R. 3438, bills to amend the bankruptcy procedures	15



1. H.R. 318—IMPOSITION OF TIRE TAX ON TIRES DELIVERED TO MANUFACTURERS' RETAIL OUTLET

(Passed the House on October 7, 1965)

Under present law (sec. 4071(a)), taxes are imposed on tires and inner tubes (10 cents a pound on highway-type tires, 5 cents a pound on other tires, and 10 cents a pound on inner tubes) at the time they are sold by the manufacturer, producer, or importer. In the case of tire and inner tube manufacturers or importers who maintain their own retail outlets, no tax is imposed until a sale is made to the consumer. When the manufacturer or importer sells to an independent tire dealer, however, the tax is paid at the time the dealer acquires the tires or tubes.

The bill provides that the manufacturers' excise tax on tires and inner tubes is to be imposed at the time of delivery to retail stores owned by manufacturers or importers, rather than at the time these tires or tubes are sold to customers. The change is to be effective as of the first day of the first calendar quarter beginning more than 20 days after the date of enactment.

The bill also imposes a floor stocks tax on inventory on hand in manufacturer-owned or importer-owned retail stores on the date the new provision becomes effective.

The House report on H.R. 318 estimates that the bill will result in a nonrecurring revenue gain of $2 million because of the speedup in the payment of the tax. Industry representatives, however, estimate that the floor stocks tax will total $12.4 million.

2. H.R. 327—ORGANIZATIONS PROVIDING FUNDS FOR TAX-EXEMPT SAVINGS INSTITUTIONS

(Passed the House on October 21, 1965)

Present law exempts from tax mutual, nonprofit organizations without capital stock organized before September 1, 1957, which provide reserve funds for, and insurance of shares or deposits in, domestic building and loan associations, cooperative banks, and mutual savings banks (sec. 501(c)(14) of the code).

This bill extends tax-exempt status to organizations similar to those described above except that they do not provide insurance of shares or deposits, provided at least 85 percent of their income is attributable to providing reserve funds and other investments.

The bill also provides that the income of both the organizations now exempt and those that would be exempt under this bill which is not related to the provision of reserves or insurance will be taxed as unrelated business income.

The provisions described above, which will have a negligible impact on revenue, would be effective for taxable years beginning after the date of enactment.

3. H.R. 6319—TAX TREATMENT OF EXPROPRIATION LOSS RECOVERIES

(Passed the House on October 21, 1965)

Present law (sec. 111 of the code) provides for the exclusion from income of recoveries of bad debts, prior taxes, and delinquency amounts, to the extent that these amounts did not reduce taxes in the year in which the expense or loss was incurred. Court decisions and Treasury regulations have expanded the categories of recoveries that may be excluded under this "tax benefit" rule. In applying this rule, the courts generally require that the amount which resulted in a tax benefit be includible in full in income. The amount of additional tax resulting from the recovery depends upon the rates of tax to which the recovery income is subject. The amount thus may be significantly larger than the amount of tax that had been saved when the item was deducted.

The bill provides a special rule in the case of recoveries of foreign expropriation losses. It provides that to the extent the amount recovered does not exceed the deductions which were allowable because of the expropriation, the amount recovered is to be excluded from income, but the tax for the year of recovery is increased by an amount equal to the increased taxes (computed at the current year's rates) which would have been payable if the deductions had not been allowed for the recovered loss. This changes present law in two major respects: (1) where the tax benefit was reduced because of the availability of tax credits, or because the deduction of the loss reduced income which was subject to rates other than the regular corporate tax rates (such as long-term capital gains and income of Western Hemisphere corporations), then similar limitations are to apply to the additional tax produced by the income arising from the recovery; (2) where certain conditions exist as to the recovery (e.g. the bulk of the recovery is in property other than cash) up to 10 years is to be allowed, with interest at 4 percent, for the payment of the tax on the recovered amount.

Another provision of the bill would treat released reserves of life insurance companies as recoveries of foreign expropriation losses under certain circumstances.

The bill also provides that in all cases where a domestic corporation has a security which became worthless, by reason of an expropriation of assets of the corporation issuing the security, and there is a restoration in whole or in part of the value of the security because of the recovery of part or all of the assets expropriated, then this increase in value is to be taken into the income of the domestic corporation. The character of the income will depend upon the character of the loss previously incurred.

This provision, except for the amendment referred to in the prior paragraph, applies to recoveries in years beginning on or after January 1, 1965, of foreign expropriation losses sustained after 1958. The amendment referred to in the prior paragraph applies to taxable years beginning on or after January 1, 1965.

This bill is the same as an amendment made by this committee to H.R. 7502, also pending before the committee, similar to a provision in H.R. 8050, a bill passed by the Senate in 1964 that was not enacted because it was not sent to conference and similar to S. 1291 referred to this committee.

4. H.R. 6568—COCONUT OIL

(Passed the House on October 18, 1965)

This bill would make permanent the duty-free treatment or lower rates of duty temporarily applicable to copra, palm nuts, and palm-nut kernels; their oils; and specified fatty acids, salts, and other chemical products derived from the oils. The temporary duty-free treatment or lower rates applicable to these products (presently scheduled to expire June 30, 1966), reflect the suspension of the processing taxes formerly applicable to such commodities under section 4511 of the Internal Revenue Code.

H.R. 6568 would also enlarge the duty-free quotas for Philippine coconut oil for the year 1965 (retroactively) and for the years 1966 and 1967 if the President determines that for these latter 2 years the Philippines has waived its rights with respect to the preferential treatment applied to Philippine copra under the Philippine trade agreement. the Philippines does waive its rights, then the bill would permit copra from all non-Communist countries to enter the United States free of duty during 1966 and 1967.

The portion of the tariff reflecting the processing tax[1] has been suspended on a temporary basis since 1957. The original suspension was for a 3-year period (through June 30, 1960). Subsequently, Congress extended this temporary suspension, first through June 30, 1963, and then through June 30, 1966.

Because of the interplay of tariff reductions under reciprocal trade agreements, the Philippine Trade Agreements Acts, and the conversion of the processing tax into an import duty and its temporary suspension, the present tariff structure on copra, palm nuts, and palm nut kernels (and their oils) is quite intricate. The Philippine Trade Agreement provides duty-free entry for a progressively diminishing quantity of Philippine coconut oil. In 1963 and 1964 the duty-free quota amounted to 160,000 tons. Under present law for 1965 through 1967, the duty-free quota is 120,000 tons. There would be no duty-free quota after 1973. This agreement also obligates the United States to maintain a 2 cents per pound preference on copra and coconut oil imported from the Philippines (3 cents if the oil is within the quota) unless the President proclaims that supplies in that country are inadequate to satisfy U.S. demands. In that event the 2-cent preference is suspended. The President has never issued such a proclamation.

The tariff structure

(*a*) *Coconut oil.*—The permanent m-f-n duty applicable to non-Philippine coconut oil is 6 cen' per pound. This duty was derived from a historical 1-cent-per-pound duty and a 5-cent processing tax. Of this 6-cent duty, 3 cents is temporarily suspended. The permanent duty for Philippine coconut oil is 3 cents per pound, if within quota, and 4 cents per pound for over-quota oil. Of each of these rates, also, 3 cents is temporarily suspended. Thus, Philippine coconut oil is currently free of duty if within quota, and subject to a 1-cent duty if over quota, whereas all coconut oil produced in other non-Communist countries is currently dutiable at 3 cents per pound. The current duty-free quota for Philippine oil is 120,000 tons.

[1] The 3 cents per pound processing tax was converted into a duty in 1963 but its suspension continued.

(*b*) *Copra.*—The present duty on Philippine copra is 1.87 cents per pound and on copra produced in other countries 3.12 cents per pound. These rates of duty were derived, respectively, from a 3-cent and a 5-cent processing tax formerly applicable. By virtue of temporary suspension of duty, Philippine copra is free of duty and other copra is dutiable at 1.25 cents per pound.

(*c*) *Palm and palm kernels.*—Historically palm nuts and palm nut kernels are duty free. The Philippine Trade Agreement does not include any preferential treatment with respect to them but the processing tax (now temporarily suspended) does apply. Thus, there is currently a statutory duty of 0.35 cent per pound applicable to palm nuts and of 1.35 cents per pound on palm nut kernels. In both cases this duty (currently suspended) is generally equivalent to the 3 cent-per-pound processing tax on the oil content of the nut or kernel.

(*d*) *Fatty acids, etc.*—In addition to the historical tariffs on fatty acids, surface active agents, soaps, and detergents, a portion of the current duty is attributable to the processing tax on the oil content of the product, but this portion is temporarily suspended.

Because of the Philippine preference our imports of coconut and copra come almost exclusively from the Philippines. Our imported palm oil and palm kernel oil, on the other hand, generally originate in Africa—principally in Nigeria, the Congo, and Liberia.

Palm oil is used primarily in making soap and in coating thin sheet iron before it is tinned to prevent oxidation. Coconut oil and palm kernel oil have identical uses and are consumed largely in making soaps, fatty acid derivatives, confectionery, and bakery products such as biscuits and crackers.

Because prices of coconut oil and palm kernel oil have been high relative to U.S. produced oils (such as soybean and cottonseed oil), consumption of coconut and palm kernel oil in soaps and foods has declined. However, their use in producing fatty acid derivatives and in synthetic detergents has increased. Proponents of H.R. 6568 urge that permanent suspension of the processing tax will slow the substitution of petroleum-based oils for these purposes and thus will aid U.S. exports of U.S. soybean and cottonseed oils to Europe. They argue that if the U.S. market for coconut oil for inedible uses is reduced, greater quantities would be shipped to European markets where it would compete with U.S. oils for edible purposes.

5. H.R. 7502—CASUALTY LOSSES ATTRIBUTABLE TO MAJOR DISASTERS

(Passed the House on August 3, 1965)

A. Provisions in bill as passed by House (secs. 1 and 2 of bill).

Under present law (sec. 1231(a) of the code) the excess of gains over losses from the disposition of certain types of property held longer than 6 months is treated as long-term capital gain. On the other hand, if the losses exceed the gains, then the net loss is treated as an ordinary loss. This treatment generally is accorded to recognized gains and losses from:

(1) Sales or exchanges of depreciable property and real estate used in a trade or business, and

(2) Compulsory or involuntary conversions of such property and of capital assets.

However, as a result of the Technical Amendments Act of 1958, where an uninsured loss results from fire, storm, or other casualty, or from theft, the loss is not to be classified as a loss to be offset against capital gain if the property was used in the taxpayer's trade or business (or was a capital asset held for the production of income). Thus these losses are ordinary losses (under sec. 165) and need not be netted against the gains treated as long-term capital gains.

This bill provides the same treatment in the case of casualty losses attributable to Presidentially-designated major disasters if the recognized losses exceed the recognized gains.

This provision in the case of business property is to apply where the losses are in part compensated for by insurance. (Of course, the insurance compensation would reduce the amount of the recognized losses.) It would also apply to personal assets (as distinct from trade or business assets) whether or not insured.

The amendment described above is applicable to taxable years ending after November 30, 1964.

Some courts have held that casualty losses are not subject to the type of treatment described above unless the taxpayer receives some property or money as compensation for the losses. This bill, in section 2, makes it clear that section 1231 applies in such cases unless specific provision excludes the loss from section 1231. This applies to losses sustained after the date of enactment of the bill.

B. Provisions added by committee

(*a*) *Investment credit* (*similar to H.R. 10433*).—Under present law (sec. 46(a)(2) of the code) the investment credit (allowed by sec. 38), generally 7 percent, may not exceed the tax liability if this is less than $25,000, or if the tax is over $25,000, may not exceed $25,000 plus 25 percent of the tax in excess of $25,000.

A committee amendment adding section 3 to this bill increases the maximum credit allowable in those cases where the tax is more than $25,000. In such cases, the new maximum credit is to be $25,000 plus 50 percent of the tax liability in excess of $25,000.

This provision is to apply to taxable years beginning on or after January 1, 1965. It also is to apply with respect to unused investment credit carryovers from prior years to calendar 1965 and subsequent years. Where a taxable year straddles the January 1, 1965, date, a proration will be made applying the new 50-percent limitation with respect to the portion of the year occurring on or after that date and the old 25-percent limitation with respect to the portion of the year occurring before that date.

Under present law (sec. 46(b) of the code), the investment credit, to the extent it exceeds the limitations referred to above, may be carried back to the 3 preceding taxable years and then, to the extent still unused, carried over to each of the 5 taxable years following the year of the investment. This section provides that, in the case of regulated transportation companies, the unused credit may be carried forward for 7 taxable years, instead of the 5 applicable to other taxpayers. (This is the same carryforward period regulated transportation companies have in the case of net operating losses.) This provision is to apply to taxable years beginning on or after January 1, 1965, with respect to carryovers from taxable years ending on or after January 1, 1962.

57-560—66——2

(*b*) *Unfunded annuities, etc.*—Under present law employee retirement plans must (among other requirements) be funded in order to qualify for income tax deferment for the amount contributed by the employer and for the earnings on contributions prior to distribution. Other tax benefits are also available for qualifying plans, including exclusion from the the estate tax base of contributions of the employer and exclusion from the gift tax for the conversion of single annuities to joint and survivor annuities.

A committee amendment, which added section 4 to the bill, enables universities to treat unfunded employee retirement programs (where specified conditions are met) for tax purposes as if they were qualified plans. For this treatment to apply the employees of the university must have had the option to come under a retirement plan which was funded and the Secretary of the Treasury must have determined that the absence of funding has not materially jeopardized the ultimate payment of the benefits. The provision applies to taxable years beginning after December 31, 1964, insofar as it relates to the income tax, to decedents dying after December 31, 1964, for estate tax purposes, and to transfers made after the calendar year 1964 for gift tax purposes.

This amendment also modifies the 20-percent limit in present law applicable in the case of nonqualified plans of tax-exempt educational, etc., organizations. This 20-percent limit under present law provides income tax deferment for amounts set aside under funded plans even though otherwise applicable antidiscriminatory coverage requirements are not met. In these cases, however, not over 20 percent of the compensation can be paid in this form. The amendment provides that for purposes of computing the 20-percent limit all of the employer's contributions to provide pension benefits for a teacher or professor are to be taken into account, and not merely the portion paid under a nonqualified pension plan. This amendment applies to taxable years beginning after December 31, 1965.

(*c*) *Disaster losses—$100 floor.*—Under present law (sec. 165(c) (3) of the code) casualty and theft losses of nonbusiness property may be deducted only to the extent that each such loss of a taxpayer exceeds $100. This limitation was added by the Revenue Act of 1964.

A committee amendment, adding section 5 to the bill, repeals the $100 floor on deduction of losses attributable to Presidentially-designated major disasters. This amendment applies to losses sustained after December 31, 1963.

(*d*) *Soil and water conservation.*—Present law (sec. 175 of the code) permits farmers to deduct currently certain expenditures for soil or water conservation or for the prevention of land erosion. These expenditures include amounts paid or incurred for the moving of earth, leveling, grading and terracing, contour furrowing, the construction of diversion channels, drainage ditches, earthen dams, etc. Deduction is allowed not only for expenditures made directly by the farmer but also for assessments paid by him levied by a soil or water conservation or drainage district to defray expenditures by the district which, if made by the farmer, would be deductible under this section.

A committee amendment, adding section 6 to the bill, permits, in addition, deduction of these assessments where they are for the purpose of acquiring machines, buildings, land, or any easement over land, or to relocate roads or powerlines or other obstructions, in connection with any of the existing deductible purposes. This provision

applies to amounts paid or incurred after December 31, 1963. In addition, where assessment payments were made between December 31, 1960, and January 1, 1964, to the extent those assessments could have been paid on an installment basis after December 31, 1963, the taxpayer is permitted to elect to deduct them.

A similar provision was added as section 3 to H.R. 8050 (S. Rept. 1602, 88th Cong., 2d sess., pp. 11–12 (Sept. 25, 1964)) and approved by the Senate on September 28, 1964. However, that bill was not enacted.

(*e*) *Local 738, I.B.T.-National Tea Co. Employees' Retirement Fund* (*context of S. 1232*).—The Local 738, I.B.T.-National Tea Co. Employees' Retirement Fund has been held by the Internal Revenue Service to be an exempt employees' pension fund (under secs. 401(a) and 501(a) of the code) for years ending on or after May 26, 1959. A committee amendment adding section 7 to this bill provides that this fund is to be considered to be a qualified exempt employee pension fund for the period beginning May 12, 1958, and ending May 25, 1959, but only if it is shown to the satisfaction of the Treasury Department that the trust has not in this period been operated in a manner which would jeopardize the interests of its beneficiaries.

(*f*) *Foreign expropriation losses.*—This provision is the same as H.R. 6319 which was passed by the House at the end of the last session, and which is also pending before the committee. The provision is explained above under H.R. 6319.

(*g*) *Subchapter R.*—Under present law (sec. 1361 of the code) partnerships and proprietorships may elect to be taxed as corporations. A committee amendment, adding section 9 to the bill, repeals this provision of present law, effective January 1, 1969. It also provides that, in the interval before the provision is repealed, an entity subject to the provisions of this section of the code may prospectively revoke its former election to become subject to the rules of subchapter R. Such a revocation would be treated as a complete liquidation of a corporation.

Under present law (sec. 1361(m)) if a subchapter R partnership or proprietorship incorporates, this is treated as a liquidation and any gain is taxed. Another provision of the bill would repeal the subsection (sec. 1361 (m)) and thereby permit such an incorporation of a subchapter R business to be treated as a tax-free reorganization.

(*h*) *Subchapter S corporations—distributions within 3½ months after the close of a taxable year.*—Under present law (sec. 1373 of the code) a corporation which has elected to be subject to the rules of subchapter S may distribute tax free its income which was previously taxed to its shareholders. (Such corporations are similar to partnerships in that the shareholders are taxed on the current income of the corporation whether or not such income is distributed to them.) Thus, current income of a subchapter S corporation, if distributed in the year earned, will only be taxed to the shareholders in that year. However, if it is distributed in the following year, it may, in some cases, be taxed to the shareholders again as a dividend. This would occur, for example, if in the following year the corporation has no taxable income or does not qualify as a subchapter S corporation. Also, in some cases where a shareholder has a different taxable year than the corporation, the shareholder may not qualify to receive tax free a distribution of the previous year's corporate income (even though the

corporation's year has ended) because he has not included the amount in his own income (since his taxable year has not yet ended).

A committee amendment, adding section 10 to the bill, treats distributions made within 3½ months after the close of a taxable year as having been made out of the undistributed taxable income of the taxable year just completed. In general, this would mean that the distribution itself will not add to the taxable income of the shareholder. This provision would apply to distributions made on or after January 1, 1965.

(*i*) *Subchapter S corporations—certain capital gains.*—Under present law (sec. 1375 of the code) a subchapter S corporation's capital gains are treated as being passed through to the shareholders whether or not those gains are actually distributed.

A committee amendment, adding section 11 to the bill, would impose a tax on the capital gains at the corporation level under certain conditions where this election had not been in effect for prior years. The tax would apply only if the net gains are greater than the other taxable income of the corporation, and exceed $25,000. The taxable income of the corporation must also exceed $25,000.

This tax is not to apply if the corporation was subject to subchapter S for more than 3 years before the capital gain year. If the corporation was less than 3 years old at that time, the tax would not apply if the corporation was subject to subchapter S at all times since its incorporation.

The amount of the corporate tax on the net capital gains is to be the lesser of (1) 25 percent of the excess of the gains over $25,000 or (2) the regular tax imposed upon the taxable income of a corporation by section 11 of the code.

This provision is to apply to taxable years beginning after enactment of the bill.

(*j*) *1939 code estate tax fraud penalty.*—Under present law, the fraud penalty is 50 percent of the deficiency in the case of estate taxes, the same as in the case of income and gift taxes. Under the 1939 code the estate tax fraud penalty was 50 percent of the entire tax. A committee amendment, adding section 12 to the bill, would bring the 1939 estate tax fraud provision into line with the 1954 code by making it 50 percent of the deficiency. This is to apply to all open years under the 1939 code.

(*k*) *Joint Committee on Reduction of Nonessential Federal Expenditures.*—Until last year no more than $10,000 could be authorized for appropriation for the Joint Committee on the Reduction of Nonessential Federal Expenditures. A committee amendment, adding section 13 to the bill, would have eliminated this restriction. This is no longer necessary, however, because such an amendment was last year added to Public Law 89-283, the Canadian Auto Agreement.

(*l*) *Self-employment retirement plans.*—Under present law income derived from the sale or licensing of intangible property (other than goodwill) arising from the personal efforts of the taxpayer (such as copyright royalty income) is not included in the basis for determining the maximum deductible contributions to a self-employed plan (H.R. 10-type plan). A committee amendment, adding section 14 to the bill, would treat such income as "earned income" for measuring contributions to such plans and for this purpose would also consider it to be income from a trade or business.

6. H.R. 7723—SUSPENSION OF DUTY ON CERTAIN TROPICAL HARDWOOD

(Passed the House on October 21, 1965)

This bill temporarily suspends the duty on certain tropical hardwood lumber. The lumber involved may be rough, dressed, or worked. The most important woods affected by the bill are balsa, teak, mahogany, lignumvitae, virola, Spanish cedar, and obeche. (There is no duty on unworked logs.)

Under the bill, the duty on this tropical lumber would be suspended until January 1, 1968, unless the United States receives appropriate trade concessions under the Trade Expansion Act. In such an event the duty-free treatment provided by this bill may be made permanent by Presidential proclamation.

The Trade Expansion Act provides for complete elimination of duty on certain tropical hardwoods which the President determines are not produced in significant quantities in the United States and with respect to which he also determines that the Common Market is eliminating its tariffs on the same products. It is also provided in the Trade Expansion Act that these tariffs may be eliminated immediately and not subjected to the general requirement for gradual elimination over a 4-year period.

The tariff on mahogany lumber could be eliminated under the Trade Expansion Act, but, since that lumber is not a "tropical product" as defined in that act, the elimination of the duty would have to be staged over a 4-year period. Under this bill the duty on lumber of mahogany could be terminated immediately.

The duty on lumber from the tropical wood covered by this bill ranges from less than 1 percent to about 2.5 percent ad valorem or its equivalent, the average being about 1 percent ad valorem during 1964.

The 10 leading supplying countries in 1964 and the amounts of tropical hardwood lumber supplied from each are shown in the following table:

Country	*Quantity (1,000 board feet)*
Colombia	21, 888
Ghana	12, 441
British Honduras	6, 523
Malaysia	9, 732
Nicaragua	6, 922
Thailand	1, 210
Ecuador	6, 299
Mexico	3, 139
Nigeria	4, 248
Brazil	4, 932

Imports from these countries accounted for about $11.2 million of the total of $13.7 million of tropical lumber imported in 1964.

Balsa lumber is used in the manufacture of models and toys, boats, aircraft, lifesaving equipment, insulation, lightweight doors, and cores for lightweight panels. There is no timber comparable to balsa grown or produced in the United States.

Teak lumber is used for boat building, flooring, decking, furniture, and decorative objects. For exterior uses there are few satisfactory domestic equivalents.

Mahogany lumber is used for models and patterns, furniture, boat construction, interior trim, paneling, radio and television cabinets,

caskets, and precision instruments. It is unexcelled for pattern stock because of its great stability. Some domestic hardwoods and the white pines are also used for pattern stock because of lower price, greater availability, or adequacy for certain uses.

The remaining category—other hardwoods—includes a large number of species embracing a wide range of physical characteristics and uses. A number have the same uses as domestic hardwoods and compete with them. Others have special uses, e.g., lignumvitae, a hard, dense, oily wood, for wooden bearings for ships, for which there is no domestic substitute. Virola is used for furniture and cabinets, paneling, and interior trim; obeche for patterns, furniture, interior trim, and boxes and containers.

The amendments made by this bill would apply to lumber entered or withdrawn from warehouse for consumption after the date of enactment of the bill.

7. H.R. 8210.—EUROPEAN SPACE RESEARCH ORGANIZATION

(Passed the House on October 21, 1965)

This bill authorizes the President to extend tax and tariff exemption (and other immunities) to the European Space Research Organization (and its foreign employees) just as such exemptions and immunities may be extended to a public international organization in which the United States participates.

Under present law, the President is authorized to extend tax and tariff exemption to a public international organization of which the United States is a member, and which is organized pursuant to a treaty or an act of Congress. Employees of such organizations who are foreign citizens or nationals similarly may be extended tax and tariff exemption and other immunities. These exemptions and immunities are provided for under the International Organizations Immunities Act (22 U.S.C. sec. 288). However, the benefits of this act are not available if the United States is not a member of the international organization.

The European Space Research Organization is a cooperative organization sponsored by 11 European nations: Belgium, Denmark, the Federal Republic of Germany, France, Italy, the Netherlands, Norway, Spain, Sweden, Switzerland, and the United Kingdom. It was established to "provide for, and to promote, collaboration among European stations in space research and technology, exclusively for peaceful purposes." The United States is not a member of this organization, and, thus, under existing law, the President may not designate the European Space Research Organization as a "public international organization."

The ESRO is seeking to build a tracking station in Fairbanks, Alaska, for use in its space research program. If the ESRO is recognized as an "international organization" for purposes of the International Organizations Immunities Act, it would be treated as though it were a foreign government entitled to bring into the United States such materials and equipment as are necessary for the construction of a tracking station without the payment of duties. Among other things, the baggage and effects of its personnel and their families would be exempt from duties and taxes imposed by reason of importation if the articles are imported in connection with their arrival in the United States.

The taxes for which exemption may be provided under the International Organizations Immunities Act include income taxes, social security, unemployment, and withholding taxes, and excise taxes.

It is understood that other nations generally afford analogous treatment to the United States in conjunction with tracking stations constructed abroad by the National Aeronautics and Space Administration in connection with our Mercury, Gemini, and Apollo programs. H.R. 8210 represents a concession to the foreign countries for the treatment that our Government seeks and obtains from them when it wants to build a tracking station abroad.

Organizations which presently are designated as "international organizations" for purposes of exemptions and immunities include the Caribbean Organization, Coffee Study Group, Food and Agriculture Organization, Great Lakes Fishery Commission, Inter-American Defense Board, Inter-American Development Bank, Inter-American Institute of Agricultural Sciences, Inter-American Statistical Institute, Inter-American Tropical Tuna Commission, Intergovernmental Maritime Consultive Organization, International Atomic Energy Agency, International Bank for Reconstruction and Development, International Civil Aviation Organization, International Cotton Advisory Committee, International Finance Corporation, International Hydrographic Bureau, International Joint Commission—United States and Canada, International Labor Organization, International Monetary Fund, International Pacific Halibut Commission, International Telecommunication Union, International Wheat Advisory Committee (International Wheat Council), Organization of American States (including Pan American Union), Pan American Health Organization, South Pacific Commission, Southeast Asia Treaty Organization, United Nations, United Nations Educational, Scientific, and Cultural Organization, Universal Postal Union, World Health Organization, and World Meteorological Organization.

8. H.R. 8436—WATCH MOVEMENTS FROM INSULAR POSSESSIONS

(Passed the House on October 21, 1965)

This bill relates to the tariff treatment of watches, clocks, and timing devices imported from insular possessions outside the customs territory of the United States. Under present law these articles and any others which are "products of insular possessions" as defined in the headnotes to the Tariff Schedules, are free of U.S. duty. Generally, this statutory test is satisfied if the product as it comes to the mainland (or Hawaii) does not contain foreign materials costing more than 50 percent of its total dutiable value.

This treatment of products of insular possessions was enacted by Congress in 1954 to stimulate the development of light industry in the possessions. However, in some instances the duty-free privilege has been manipulated to the detriment of domestic industries on the mainland.

Thus, in the case of wristwatch movements, for instance, the regular duty ranges from $2.70 to $3.85 for a 17-jewel movement and is $10.75 for a 21-jewel movement. An identical product imported from the Virgin Islands or Guam would be duty free. This tariff savings has prompted the formation of at least 14 assembly plants in

the Virgin Islands—5 owned by U.S. watch movement producers—which in 1965 shipped approximately 3.6 million jewel-lever watch movements to the mainland free of duty. This was about 12 percent of U.S. consumption of all watch movements and about one-fourth of U.S. consumption of jewel-lever movements.

In addition to the Virgin Islands operations, it is understood that there is presently one assembly plant functioning on Guam. Both the Guam and the Virgin Islands plants use parts originating in Japan, France, or West Germany, and in both possessions the assembly work is peformed by local employees—about 600 in the Virgin Islands and 40 on Guam.

Recently, in anticipation of Federal restrictions on the duty-free treatment of products shipped from the possessions,[1] the Virgin Islands Legislature approved a measure to restrain shipments of watch movements to the mainland to about one-ninth of U.S. consumption. H.R. 8436, by specifically excluding the Virgin Islands from its application, in effect gives recognition to this local statute.

Under the bill watches, clocks, and timing devices assembled in Guam or American Samoa would become dutiable at the regular rates. Specifically, the duty would be at the rate which would apply if the assembled movement were imported from the country of origin of the component of chief value. Such articles assembled in the Virgin Islands, however, would continue to be duty free.

9. H.R. 8445—RETIRED PAY OF JUDGES OF THE TAX COURT

(Passed the House on October 21, 1965)

Under present law the retired pay of a judge of the Tax Court is based on the salary payable to him as a judge "at the time he ceases to be a judge."

Under this bill, the retired pay of Tax Court judges is to be computed on the basis of the salary of the office, that is, in a manner similar to that presently provided for judges of other Federal tribunals.

The provisions of the bill would be effective with respect to retired pay accruing on or after the first day of the first calendar month which begins after the date of enactment.

10. H.R. 10625—TREATMENT OF CERTAIN AMOUNTS PAID TO SERVICEMEN AND THEIR SURVIVORS

(Passed the House on October 21, 1965)

Presently, amounts paid to survivors under the retired serviceman's family protection plan do not qualify as payments from qualified pension plans because the plan is not funded. Therefore, retired servicemen who elect to receive a reduced amount of retirement pay in order to provide an annuity for their survivors are taxed as if no reduction were made. Furthermore, their survivors are not eligible for the $5,000 exclusion for death benefits paid to a survivor by reason of the death before retirement of an employee. Nor are such plans eligible

[1] On Nov. 15, 1963, the Secretary of the Treasury submitted legislation to Congress designed to amend present law with respect to possessions to stop further "development of a loophole." See H.R. 9320 of the 88th Cong.

for certain estate and gift tax provisions available to qualified pension or annuity plans.

Under this bill, the amount of a reduction in retirement pay accepted to provide survivors' annuities is no longer to be taxed as income to a retired serviceman when he receives the reduced retirement pay. Such amounts included in the taxable income of servicemen in the past may be offset against otherwise taxable retirement pay received in the future. Moreover, the exclusion of up to $5,000 paid to a survivor on account of the death of an employee is made available to survivors of servicemen who retire because of disability and die before attaining normal retirement age. Finally, the estate and gift tax exclusions available under present law for the value of survivors' annuities in the case of civil service annuities are made available in the case of annuities provided to survivors under the retired serviceman's family protection plan.

The bill's income tax provisions would apply to retirement pay received after December 31, 1965, or, in the case of the death benefit exclusion, to those who die after that date. The estate tax amendment applies to estates of decedents dying after December 31, 1965, and the gift tax amendments to gifts made after the calendar year 1965.

11. H.R. 11029—CERTAIN WOVEN FABRICS

(Passed the House on October 5, 1965)

This bill relates to the tariff status of two types of woven fabric. The first type involves fabrics made of a mixture of ramie (or flax), rayon or other manmade fibers, and cotton. The other fabric is made of blended yarn containing small amounts of high-value rabbit hair and a large amount of low-value reprocessed wool.

Ramie-rayon-cotton fabric

In the Tariff Schedules Technical Amendments Act of 1965, Congress dealt with a tariff avoidance problem whereby fabric made of yarn containing more than 50 percent by weight of rayon or other manmade fibers and a small amount of high-value ramie or flax was avoiding the relatively high U.S. tariff on fabrics of manmade fibers. Even before the 1965 act finally became law, means were found to avoid the amendment Congress was in the process of enacting. The new method involves the addition of small amounts of cotton to yarns as a substitute for rayon, thereby reducing the manmade fiber content of the fabric to less than 50 percent. As a result, the fabrics become dutiable at 6.5 percent or 10 percent ad valorem rather than at the rayon rate of 25 cents per pound plus 22.5 percent ad valorem.

This bill would further amend the 1965 amendment to reinstate the rayon rates to this fabric. Under the bill the duty on this type of cloth would be 25 cents a pound plus 22.5 percent ad valorem.

Wool-rabbit fur fabric

The 1965 act also dealt with a second rate avoidance problem, this one involving a combination of a small quantity of high-value flax (or ramie) with a large quantity of low-value wool (generally reprocessed or reused wool) to create a fabric which, although 75 to 85 percent by weight of wool, was nevertheless in chief value of the vegetable fiber

and dutiable at 10 percent ad valorem. The duty on wool fabric, generally, would be 37.5 cents per pound plus 60 percent ad valorem. The 1965 amendment corrected the wool-ramie situation by subjecting such a fabric to a compromise duty of 30 cents per pound plus 45 percent ad valorem which is, generally, equivalent to a duty based on paragraph 1122 of the old tariff structure. (Under the old tariff structure, prior to August 31, 1963, woven fabrics containing 17 percent or more of wool by weight were, in effect, separated into their component fibers with wool rates applying to the wool content and other rates applying to the nonwool content of the fabric.)

Recently, there have been increasing imports of a new type woolen fabric containing small quantities of high-value rabbit hair and quantities of low value reprocessed wool. Since rabbit hair (or other animal fur) comprises the chief value of the fabric, it is presently dutiable at only 17.5 percent, rather than the much higher rates for wool fabrics. This bill would amend the present law to treat such a woven fabric of wool and fur at a compound duty of 30 cents per pound plus 50 percent ad valorem. As in the case of the 1965 amendment, this compromise rate is, generally, equivalent to the duties which would have applied to this fabric under section 1122 of the old tariff structure.

Effective date

As passed by the House on October 5, 1965, the amendments made by this bill would have applied with respect to imports entered or withdrawn for consumption after December 7, 1965. In view of the passage of time, this effective date may no longer be appropriate since it would involve an increase in duties on articles already imported.

12. H.R. 11216—ARTICLES ASSEMBLED ABROAD

(Passed the House on October 21, 1965)

Prior to the inauguration of the Tariff Schedules of the United States in August 1963, articles assembled abroad in whole or in part of fabricated components produced in the United States were by virtue of court ruling partially exempt from duty. The theory of the court ruling, which related to a U.S. motor exported for installation in a foreign motorboat which was then shipped to this country, was that the American component had not been advanced in value or improved in condition by the assembly process. The court ruling (*C. J. Tower and Sons* v. *United States*, CD 1628 (1954)) introduced anomalies into the customs treatment of imported articles containing U.S. components, such as, for instance, attributing advance in value arising from the assembly operation wholly to the foreign components in the assembled article. Another anomaly growing out of this court ruling was the doctrine of "constructive segregation" under which duty-free treatment applied if the U.S. components were readily identifiable and could be removed without injury to the assembled article.

In the Tariff Schedules of the United States a specific provision (Item 807.00) continued this court-approved practice. However, the new provision eliminated the anomalies involved in the old practice, first by recognizing that U.S. components do increase in value by assembly operations and second by making it unnecessary to show

that the U.S. component could be removed without injury to the assembled article. At the same time it was provided that for the duty-free treatment to apply on its return the U.S. component must have been sent abroad "for the purpose of assembly."

In the Tariff Schedules Technical Amendments Act of 1965 item 807.00 was clarified to make it clear that cleaning, lubricating, and painting could be performed in connection with the assembly function without subjecting the U.S. components to duty on their return to this country. In making this clarification, however, an additional restrictive clause was added to the duty-free provision. It requires that at the time of exportation of the U.S. component there be an intention that the assembled article is to be shipped to the United States. This additional restriction has raised complaints by interested importers and foreign shippers, and has also been said to introduce problems of customs administration.

H.R. 11216 would eliminate both the requirement that the American component be exported "for the purpose of such assembly" and the requirement that there be an intention at the time of exportation that it be returned to the United States. It would still be necessary, however, for the importer to establish by satisfactory proof that the components of an imported article for which duty-free treatment is claimed are, in fact, components produced in the United States. Moreover, it must be shown that they have not lost their physical identity in the assembled article and have not been advanced in value or improved in condition abroad except by the assembly operation, or operations, incidental to assembly.

The bill as passed by the House would apply as if the amendments were made by the Tariff Schedules Technical Amendments Act of 1965. This means, in effect, that refunds of tariffs paid on American products assembled abroad would be available to the importer with respect to articles imported after August 30, 1963. However, the 1965 act required that claims for refunds of duty must be filed within 120 days after enactment (Oct. 7, 1965). This means that unless the bill is enacted into law before February 4, 1966, this refund procedure would not apply.

13. H.R. 136 AND H.R. 3438 [1]—BILLS TO AMEND THE BANKRUPTCY PROCEDURES, RE-REFERRED TO THE COMMITTEE ON FINANCE AFTER FAVORABLE CONSIDERATION BY THE COMMITTEE ON THE JUDICIARY

(Passed the House on August 2, 1965)

The three major proposals contained in these bills involve: (*a*) the circular priority problem; (*b*) priorities of "secret" tax liens; and (*c*) the discharge of remaining tax liabilities after a bankruptcy.

(*a*) *Circuity of preferences*

The problem of circular priority results as a consequence of conflicting preferences assigned different types of claims or liens in bankruptcy. If the assets of a bankrupt estate are not sufficient to satisfy all claims, the problem arises as to the portion of the assets of the estate to be allocated to each claim.

[1] These two House bills are essentially the same as S. 1912 and S. 976.

In bankruptcy, secured claims are paid first. Both the tax lien and the judicial lien are examples of secured liens and if the tax lien is first in time, it would ordinarily be paid before the judicial lien. However, the Bankruptcy Act (sec. 67) provides that statutory liens on personal property (unaccompanied by possession) are to be postponed to the administrative expenses and certain wage claims of the bankrupt estate. Despite this postponement, the judicial lien, which is not a statutory lien, is not so postponed by the Bankruptcy Act. Consequently, there arises the classic circular priority problem: the tax lien is superior to the judicial lien, but the tax lien is postponed to the administrative expenses and wage claims while the judicial lien is not so postponed.

The courts have interpreted present law as providing a number of different solutions to this circuity problem.

H.R. 136 would solve the problem by changing present law in three respects. It defines what constitutes a "statutory lien" for purposes of the Bankruptcy Act (sec. 1 of H.R. 136), alters types of liens to be postponed (sec. 5 of H.R. 136), and also establishes a pattern of payment for those liens which are postponed (sec. 5 of H.R. 136).

With respect to the definitional problem, the bill limits the "statutory lien" to those which arise by force of statute (such as a tax lien) and excludes those merely protected or regulated by statute (such as a chattel mortgage). This amendment clarifies the question as to the type of liens which are to be treated as "statutory liens." Therefore, those liens which are merely protected or regulated by statute will not be postponed.

The circular priority problem is resolved by the following scheme:

1. *Nonpostponement.*—With the exception of tax liens (Federal, State, and local), statutory liens on personal property, not accompanied by possession would no longer be postponed. Thus, the circuity problem in this manner would be limited to tax liens. However, the tax liens referred to above would continue to be postponed.

2. *Pattern of payment.*—To resolve the circular priority problem which otherwise would result from the postponement of these tax liens, a pattern of payment would be provided by the bill. The pattern of payment provides that every statutory tax lien on personal property not accompanied by possession would be postponed in payment to the administrative expenses and wage claims (whose priority is established in clauses (1) and (2) of sec. 64a of the Bankruptcy Act). If the statutory tax lien is prior in right to liens indefeasible in bankruptcy (for example, a judicial lien), the proceeds from the sale of the personal property to which the statutory tax lien attaches (less actual cost of the sale) would be allocated first to the payment of the administrative expenses and wage claims, and to the extent of any excess over these debts, to the statutory tax lien. The indefeasible lien, which is next in time to the Federal tax lien, would then be paid out of the remaining proceeds. Also, if the personal property sold were subject to a chattel mortgage prior in right to the Federal tax lien, the chattel mortgage would, of course, be paid first, even before the administrative expenses or wage claims. Additionally, in a case where there are not sufficient funds to pay the tax lien in full, any deficiency remains a claim which (under sec. 64a(4)) is entitled to a priority from the other assets of the estate.

(b) Secured or priority status of tax claims

In bankruptcy there are two classes of claims—secured and general. However, within the category of general claims certain priorities of payment are established. These groups have priority over general creditors.

In general, the Bankruptcy Act provides that in the case of a bankruptcy, secured claims are entitled to be paid the amount of their claims from the properties which are their security. Secured claims included mortgages, pledges, judgments, and tax liens whether on real or personal property and whether or not recorded. The remaining funds of the bankrupt estate are distributed first to the claims given priority status by the Bankruptcy Act and then to the general creditors. The following is the established priority (sec. 64a of the Bankruptcy Act):

1. Costs of administration;
2. Wage claims;
3. Costs of refusing a discharge;
4. Taxes, Federal, State, and local; and
5. Certain debts owed to any person entitled to priority under Federal law and rents.

Federal tax liabilities are by statute established as secured claims if the tax liabilities have been assessed and the taxpayer has received notice and demand of the taxes owed (sec. 6321 of the Internal Revenue Code). It is not necessary for a notice of a tax lien to be filed for the tax liabilities to be accorded secured status.

However, the Internal Revenue Code (sec. 6323) provides that the tax lien is not valid as against mortgagees, pledgees, purchasers, or judgment creditors until notice of the lien has been filed. Therefore, as against the interests of these types, the unfiled Federal tax lien is treated as a junior claim. In the very recent case of *In re Kurtz Roofing Co.*, (decided December 13, 1965), affirming (6th Cir., 1964) 335 F. 2d 311, *sub nom. U.S.* v. *Speers*, the Supreme Court interpreted the Bankruptcy Act (sec. 70c) as conferring upon the trustee in bankruptcy the status of judgment creditor within the meaning of that term as used in the Internal Revenue Code (sec. 6323). Therefore, since the trustee represents all the general creditors in a bankruptcy proceeding, the Government's claim for unpaid taxes, where the lien was not filed, is reduced to the status of an unsecured claim, sharing fourth-class priority with unsecured State and local tax claims (sec. 64a(4) of the Bankruptcy Act) and ranking behind administrative expenses, certain wage claims, and specified creditor expenses.

No change is suggested by the House bills with respect to the secured status of Government tax claims where the notice of lien has been filed. However, if the taxes have been assessed but no notice of lien has been filed, significant changes are proposed with respect to both the secured status and the priority of payment status of these claims. It should also be remembered that these bills were drafted prior to the Supreme Court decision in the *Kurtz Roofing Company* case.

1. *Judgment creditor.*—The most important amendment under the House bills would provide that tax claims for which no notice has been filed lose their secured status (sec. 5 of H.R. 136). This result is obtainable by making the trustee in bankruptcy a judgment creditor. As indicated above, the Supreme Court in the *Kurtz*

Roofing Company case decided that the present statutes provide that a trustee in bankruptcy is a judgment creditor. Prior to this case, a number of circuit courts had held that although the trustee in bankruptcy is treated as a judgment creditor, he does not constitute a "judgment creditor" within the intent of the Internal Revenue Code (sec. 6323).

2. *Priority amendments.*—Section 3 of H.R. 3438 amends the fourth category of priority to limit the claims in this category to those which are not released in the new discharge provisions of that bill (sec. 2). The discharge provision, in turn, provides for the discharge of tax claims which have been "legally due and owing" for more than 3 years prior to bankruptcy. In discussion with the proponents of these bills subsequent to their consideration by the Senate Judiciary Committee, it was understood that the date of "tax assessment" would be substituted for the terms "legally due and owing." In other words under this proposal, taxes which have been assessed more than 3 years prior to bankruptcy for which no lien has been filed would be excluded from the fourth category of priority. Additionally, these taxes do not fall into the general governmental claims priority, the fifth category of priority, since as amended by section 3 of H.R. 136 the fifth category of priority specifically excludes tax debts.

(*c*) *Discharge in bankruptcy*

Under present law Federal tax claims are not discharged in bankruptcy. Section 2 of H.R. 3438 amends the Bankruptcy Act to provide for the discharge of certain tax claims. This section would, subject to certain exceptions, discharge tax claims, whether or not filed as liens, which were assessed against the bankrupt 3 years or more prior to the bankruptcy.