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Report
No. 1724

SUSPENSIONS OF INVESTMENT CREDIT AND ACCELERATED DEPRECIATION

REPORT

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

TO ACCOMPANY

H.R. 17607

A BILL TO SUSPEND THE INVESTMENT CREDIT AND THE ALLOWANCE OF ACCELERATED DEPRECIATION IN THE CASE OF CERTAIN REAL PROPERTY

OCTOBER 13, 1966.—Ordered to be printed

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Mr. LONG of Louisiana, from the Committee on Finance, submitted the following

REPORT

[To accompany H.R. 17607]

The Committee on Finance, to which was referred the bill (H.R. 17607) to suspend the investment credit and the allowance of accelerated depreciation in the case of certain real property, having considered the same, reports favorably thereon with amendments and recommends that the bill as amended do pass.

I. SUMMARY

H.R. 17607 as passed by the House is designed to moderate the pace of the economy to a more sustainable level of economic growth. Your committee has accepted this objective of the House and reported the bill with relatively few modifications (described subsequently). This bill is an integral part of a coordinated anti-inflationary program of the administration. Other features of the program include an expenditure reduction of at least $3 billion and measures designed to relieve the pressures of government borrowing on the money market. This bill, together with the other features of this program, is designed to restrain inflationary forces by moderating economic activity in those sectors of the economy where inflationary pressures are the strongest. The primary features of this bill directed at this result are the suspension for approximately 15 months of two tax incentives for investment in plant and equipment and other investment property; namely, the 7-percent investment credit, and, in the case of buildings not eligible for the credit, accelerated depreciation. By temporarily removing these incentives for business investment, the bill, and the other parts of the program, also will ease pressures in the money market, thereby promoting a greater flow of credit into the home mortgage market.

The provisions of this bill—including the amendments made by your committee—may be summarized as follows:

Suspension of the investment credit.—The bill as passed by the House temporarily suspended the investment credit for the period from September 9, 1966, through December 31, 1967. As amended by your committee, the bill suspends the credit from October 10, 1966, through December 31, 1967, or for approximately 15 months instead of 16 months.

Under the House bill, the investment credit, however, would continue to apply to investments of up to $15,000 made by a taxpayer or a business during the suspension period. Your committee has modified this rule to provide that the investment credit will, during the suspension period, continue for investments of up to $25,000 instead of $15,000. Additionally, your committee has provided an exemption for railroad rolling stock (other than locomotives) so that purchases of this property will continue to be eligible for the investment credit. Furthermore, under both versions of the bill, an exception is made—so the suspension will not apply—for property acquired or constructed pursuant to a contract binding on the taxpayer at all times after the beginning of the suspension period.

Investments for which no credit is allowable, because they represent acquisitions or orders during the suspension period, lower the maximum limitation with respect to which credits may be claimed for investments for the year involved and in that way decrease the amount of other investments for which a credit may be taken during the year—either in the form of investments made during the year or as carryovers from other years.

Suspension of accelerated depreciation on buildings.—The bill, as passed by the House, also suspends the use of accelerated methods of depreciation with respect to buildings (other than those eligible for the investment credit) which are constructed or ordered during the suspension period. Your committee accepted this provision except that it provided an exception for up to $100,000 of construction during the suspension period for which the accelerated depreciation methods will remain available. This $100,000 is available only where the total construction involved is $100,000 or less. Under both the House and your committee's version of the bill, depreciation on buildings where the accelerated methods are denied will have to be computed under the straight line method or the declining balance method at a rate 1½ times the applicable straight line rate (or under some other method which provides a similar reasonable allowance for depreciation). The double declining balance method and the sum of the years-digits method (except for the $100,000 of construction referred to above) will not be available at any time in the future for buildings constructed or ordered during the suspension period. (This is due to the operation of existing law which provides that these accelerated depreciation methods are available to new assets only.) As in the case of the investment credit, an exception is provided for buildings whose construction was begun prior to the start of the suspension period or whose construction was contracted for under the terms of a contract binding on the taxpayer before the start of the suspension period.

Rules common to the suspensions of the investment credit and of accelerated depreciation.—As noted, the investment credit and the use of accelerated depreciation methods are not to be denied in the case

of property whose physical construction was begun before the beginning of the suspension period. Nor are they to be denied with respect to property constructed or acquired pursuant to a contract which was binding on the taxpayer before the beginning of the suspension period, and at all times thereafter.

Under both versions of the bill a building constructed or equipped pursuant to a plan drawn up before the suspension period and not substantially modified during the period, the investment credit or the use of accelerated methods of depreciation, as the case may be, is not to be denied if more than 50 percent (of the adjusted basis) of the depreciable property making up the equipped building is attributable to items whose construction was begun before the beginning of the suspension period, plus items which were ordered under contracts binding on the taxpayer on or before the beginning of the supsension period. Where an "equipped building" qualifies under this rule for the investment credit or for the use of accelerated depreciation, one or the other of these provisions (depending on the type of asset) is also to be available for incidental appurtenances located outside the building which are necessary to the functioning of the equipped building.

Your committee has added a rule (somewhat similar to the equipped building rule) relating to a "plant facility" which does not include any significant building structure, yet is a self-contained operating unit or processing operation located on a single site and identified on October 9 in the purchasing and internal financing plans of the company as a single unitary project. The investment credit is to be available where a taxpayer had a plan for such a plant facility on October 9, 1966, and either construction began (generally at the plant site) on the facility before October 10, 1966, or more than 50 percent of the basis of the depreciable property making up the plant facility was attributable either to construction which was begun by the taxpayer before October 10 or property the taxpayer had acquired or had under a binding contract before that date.

The bill as passed by the House contained a general rule in determining when machinery and equipment was to be eligible for the investment credit and a special rule applicable in the case of a taxpayer who regularly manufactured or assembled machinery and equipment for his own use. Your committee's amendments substitute a new provision which provides that machinery and equipment is to be eligible for the investment credit where 50 percent of the parts and components were held by the taxpayer on October 9, 1966, or acquired by him under a binding contract in effect on that date. However, for this rule to apply, the parts and components must not be an insignificant portion of the total cost. This report also specifies rules to be followed in determining when the construction of machinery has begun. These rules, in general, provide that the construction of machinery or equipment has begun when significant installation or parts-manufacturing occurs or when assembly has commenced.

The investment credit or the use of accelerated methods of depreciation, as the case may be, is not to be denied where a person who is a party to a contract binding on and after the commencement of the suspension period, transfers either the rights to the contract (or the property to which the contract relates) to another person in which a

party to the contract retains the right to use the property under a lease. Under the House bill, these contract transfers involving lease arrangements were required to be in connection with financing transactions. Your committee's bill removes this requirement. In addition, the lease arrangements under the House bill had to be long-term leases. Your committee's bill continues this requirement only where the lessor elects to retain the investment credit.

The investment credit or the use of accelerated methods of depreciation, as the case may be (subject to certain limitations), is not to be denied to property constructed or acquired under the terms of a lease agreement entered into before the beginning of the suspension period, provided the agreement obligates the lessee or lessor to construct or acquire such property. The House bill also applies this same rule in the case of sales contracts. Your committee's amendments retain this rule but clarify its application.

Both the House and your committee's versions of the bill also provide that property transferred at death or in certain other transactions (generally those in which the transferee assumes the transferor's basis in the property) is to have the same status in the hands of the transferee as it had in the hands of the transferor with respect of any binding contracts, etc.

The relaxation of certain limits on the investment credit.—The bill also provides that, effective for taxable years beginning after the end of the suspension period (Dec. 31, 1967), the amount of investment credit which may be claimed in any taxable year is to be an amount equal to the entire tax liability up to $25,000 plus 50 percent of any tax liability over $25,000, instead of $25,000 plus 25 percent of any tax liability over $25,000 as is provided by present law. The bill also extends the period in which unused investment credits may be carried forward to 7 years (presently it is 5 years). In the latter case, the extended carryforward period generally will be effective with respect to carryovers from taxable years ending after December 31, 1961.

Treasury savings bonds not subject to the interest rate ceiling.—This committee amendment authorizes the Treasury Department to issue a new type of retirement and savings bond at whatever rate of interest is deemed appropriate. The bonds are to mature in not less than 10 years but not more than 30 years.

II. REASONS FOR THE BILL

This bill is part of an overall program designed to moderate the pace of the economy to a level more compatible with the rate of increase in our physical capacity to produce, to begin the return to price stability and to relieve the distortions among various sectors of the economy which arise from widely different rates of growth. By removing certain tax incentives for investment in machinery, equipment, and buildings, the bill will ease inflationary pressures in those sectors where demands for output are straining present productive capacity. This action also will have the effect of reducing pressures tending to raise interest rates and will promote an increased flow of credit into the home mortgage market. Moreover, the bill can be expected to produce a short-run improvement in the Nation's balance-of-payments position as demand for output is brought into balance with the existing capacity to produce the output.

The provisions of the bill form an integral part of a broader administration program designed to curb inflationary pressures. The other features of this program—which provide for expenditure reduction and an effort to ease the burden of monetary restrictions—are outlined below.

The bill is part of a comprehensive program

This bill is a part of a comprehensive program announced by the President to protect the uninterrupted growth of the economy at stable prices. The other elements in this program—a substantial cutback in Federal expenditures and a reduction in issues of Federal securities—will complement and strengthen the anti-inflationary impact of this bill. In combination, the various components of this program are highly interrelated and will focus anti-inflationary restraint on those sectors of the economy that require restraint.

In his message, the President stated that he would "cut all Federal expenditures to the fullest extent consistent with the well-being of our people." While determination of the precise amount of the overall reduction which will be possible cannot be made until congressional action on the remaining appropriations bills is completed, the President and the Director of the Bureau of the Budget estimate that contracts, new orders, and commitments will be reduced by at least $3 billion in the fiscal year 1967. This amount is equal to approximately 10 percent of that portion of the budget which is not allocated either to the defense effort or to payments fixed by law or which are otherwise uncontrollable. The President has already directed that contracts, new orders, and commitments for lower priority programs be cut by $1.5 billion.

Expenditure cutbacks will be achieved in a variety of ways. In the words of the President:

> Federal civilian agencies have been directed to defer, stretch out, and otherwise reduce contracts, new orders, and commitments. Each major agency has been given a savings target, with orders to meet that target.
>
> I am prepared to defer and reduce Federal expenditures—
>
> By requesting appropriations for Federal programs at levels below those now being authorized by the Congress;
>
> By withholding appropriations provided above my budget recommendations whenever possible; and
>
> By cutting spending in other areas which have significant fiscal impact in 1967.

The third element in the administration's overall anti-inflationary program is a coordinated effort to ease the burden of monetary restrictions and promote the early reduction in interest rates. Your committee's bill will make an important contribution by reducing some of the demand for money, but it is only a part of a broader program. The Secretary of the Treasury has been directed to review all prospective sales of Federal securities in order to reduce to a minimum the volume of such sales in particular sectors of the money market. This effort will serve to curtail Federal demands for long-term capital,

thereby releasing more funds for private use. The Secretary of the Treasury stated that progress has already been made under this directive:

> It has already been decided to cancel the sale of FNMA participation certificates tentatively scheduled for September, and to have no FNMA participation sale in the market for the rest of 1966 unless market conditions improve. Nor will there be any Export-Import Bank sale of participation certificates in the market in the rest of this calendar year. Market sales of Federal agency securities, meanwhile, will be limited in the aggregate to an amount required to replace maturing issues, while new money, to the extent genuinely needed, will be raised through sales of agency securities to Government investment accounts.

The President has also called upon banks to handle money and credit equitably and to refrain from charging excessive interest. He has urged them to rely less upon high interest rates to ration available credit and more upon the use of appropriate credit ceilings.

Finally, the President has asked the Federal Reserve Board and the Nation's largest commercial banks to seize the earliest opportunity to lower interest rates. This opportunity will not arise, however, if heavy reliance must be placed on monetary policy to restrain inflationary pressures. Prompt passage or H.R. 17607, therefore, is essential to the success of this program.

The state of the economy

The economy is now in the 67th month of uninterrupted expansion following the recession low reached in February 1961. During this expansion—with the exception of the World War II period, the longest expansion in U.S. business cycle annals—the economy has recorded solid gains. The rate of unemployment in this period has fallen from a high of almost 7 percent to 3.9 percent of the civilian labor force despite the addition of 5.5 million new members to the labor force. Moreover, hourly compensation among nonfarm workers, which rose by only 3.2 percent from 1960 to 1961, rose 5.2 percent from 1965 to 1966. The rate of capacity utilization in manufacturing has risen from 78 percent in the first quarter of 1961 to 93 percent in the second quarter of 1966 despite an increase of more than 25 percent in manufacturing capacity. As a result, the index of industrial production is currently more than 40 percent above its average 1961 level, per capita disposable income is currently running at an annual rate 28 percent above the 1961 average, and corporate profits are currently running at an annual rate nearly 60 percent above the 1961 average.

Before 1966.—The prudent exercise of fiscal policy has been instrumental in sustaining the expansion. The 7-percent investment credit provision of the Revenue Act of 1962 encouraged increased investment in new plant and equipment at a time when the sluggish pace of such investment was a matter of serious, general concern. The enactment of the Revenue Act of 1964 stimulated consumption and investment spending by reducing taxes on individual and corporate incomes by more than $11 billion. The Excise Tax Reduction Act of 1965 provided a further stimulus to the economy by reducing and eliminating Federal excise taxes on a wide range of items including both consumer goods and investment goods. The carefully staged tax reductions and

selective tax incentives provided by these various legislative acts and by depreciation reform supported rapid economic growth and helped to return the economy to near capacity levels of production. These various tax reductions—from the Revenue Act of 1962 through the Excise Tax Reduction Act of 1965 (and including the administrative action with respect to depreciation guidelines)—in terms of current income levels represent an aggregate annual tax reduction of approximately 21 billion.

Until the middle of 1965, when the demands placed upon the economy by the conflict in southeast Asia intensified, the course of the expansion was marked by an unusual degree of price stability. The wholesale price index remained at virtually the same level from the end of 1961 through the end of 1964. Over the same period the consumer price index rose at the relatively low rate of 1.2 percent a year. However, prices began to rise in the latter part of 1965. The wholesale price index rose by 2.0 percent in 1965 while the consumer price index rose by 1.7 percent. As the year closed, it became apparent that price increases were spreading throughout the economy.

Restraining actions during 1966.—Early this year the Congress responded to the threat of inflation by enacting the Tax Adjustment Act of 1966. Without increasing actual income tax liabilities, this act reduced individual disposable incomes and corporate cash flow by accelerating the payment of taxes to such an extent that budget receipts in fiscal year 1966 were increased by an estimated $1.1 billion and receipts will be increased in fiscal year 1967 by about $3.6 billion. The act also restored the excise tax rates on automobiles and telephone service to their pre-January 1, 1966, levels. The anti-inflationary impact of the Tax Adjustment Act was supplemented by the effect of social security tax increases and by an administrative order accelerating the payment into Federal depositories by employers of withheld income taxes and social security taxes.

The increase in revenues provided by the Tax Adjustment Act of 1966, the acceleration of payments of withheld tax, and the increase in revenues associated with rapidly expanding incomes, coupled with the fact that traditional increases in purchases at the end of the fiscal year were held down, trimmed the deficit in the administrative budget for the fiscal year 1966 from the $6.4 billion projected in January to an actual total of $2.3 billion. It is expected that the Tax Adjustment Act of 1966 through the restored excise taxes, graduated withholding on wages, and the speedup of corporate taxpayments will remove approximately $3 billion from the spending stream in the calendar year 1966. Coupling this with the administrative action accelerating taxpayments, which accounts for approximately $1 billion more, and the $6 billion representing indcreased payroll taxes for social security and medicare, it is estimated that approximately $10 billion of business or consumer purchasing power has been removed from the economy this calendar year.

These actions, in combination with monetary restraint, aided in moderating the economy's rate of advance in the spring of the year. The pace of economic activity has since accelerated, however, and inflationary price pressures have continued to mount. In the first 7 months of 1966, the wholesale price index rose at an annual rate of 3.8 percent, while consumer prices advanced at an annual

rate of 3.1 percent. These developments have been accompanied by monetary restrictions of increasing severity.

It is now apparent that heavy reliance on monetary restraint in the past several months has not succeeded in controlling inflationary pressures, nor has it distributed the burdens of inflationary restraint evenly over the economy. On the one hand, the scarcity of funds for financing home mortgages and the high interest rates prevailing on such mortgages have led to a sharp decline in housing starts. In August the level of such starts was nearly 30 percent below the 1965 average. The prolonged decline in the prices of corporate shares that began in February of this year has also been attributed largely to high interest rates and a restricted supply of funds.

Business investment spending.—General credit restraint has not, on the other hand, moderated business investment spending. The regular survey conducted by the Securities Exchange Commission and the Department of Commerce revealed earlier in the year that businessmen planned to spend $60.8 billion for new plant and equipment in 1966, or 17.0 percent more than they spent for this purpose in 1965. The magnitude of this increase is apparent from the fact that such expenditures increased by 15.7 percent in 1965, by 14.5 percent in 1964, and by an annual average of only 6.8 percent in 1962 and 1963. The most recent SEC-Department of Commerce survey reveals that business firms have not scaled down their earlier plans despite lengthy order backlogs for machinery and equipment, the prevalence of the highest interest rates in 30 to 40 years, and a general scarcity of funds to finance long-term investment.

Table 1 indicates that the net increase in credit market liabilities of corporate nonfinancial business has increased sharply in the last 2 years. The rate of increase thus far in 1966 is more than double the rate of increase in 1964 and more than three times the rate in 1961. At the same time, table 2 indicates that the annual rate of increase in net mortgage debt in the first half of 1966 has declined somewhat from the level of 1963 through 1965. This suggests that funds have been diverted from other sectors of the money market to finance a rapid expansion in business borrowing which has helped to sustain a high level of investment in plant and equipment.

TABLE 1.—*Net increase in credit market liabilities of corporate nonfinancial business*

[In billions of dollars]

	1961	1962	1963	1964	1965	1966 [1]
Corporate bonds	4.6	4.6	3.9	4.0	5.4	10.9
Corporate stock	2.5	.6	−.3	1.4	.3	2.7
Mortgages	1.7	2.9	3.4	3.4	3.5	3.0
Bank loans	(2)	2.4	2.8	3.4	9.9	9.8
Other loans	.3	−.7	.5	1.3	1.2	2.2
Total	9.1	11.2	10.3	13.5	20.2	28.4

[1] Seasonally adjusted annual rate for first half of 1966.
[2] Less than $50,000,000.

NOTE.—The data in this table may not add to totals shown, because of rounding.

Source: Board of Governors of the Federal Reserve System flow of funds accounts.

TABLE 2.—*Total net mortgage lending*

[In billions of dollars]

	1961	1962	1963	1964	1965	1966 [1]
1 to 4 family	11.8	13.4	15.7	15.5	15.4	14.0
Other	5.1	7.9	9.0	10.1	10.1	9.6
Total	16.9	21.3	24.7	25.6	25.5	23.5

[1] Seasonally adjusted annual rate for first half of 1966.

Source: Board of Governors of the Federal Reserve System flow of funds accounts.

The present demand for investment goods exceeds the Nation's capacity to produce such goods. As a result, new orders tend to be reflected in increased backlogs of unfilled orders rather than in increased production. Tables 3 and 4 present evidence to support this conclusion. The volume of unfilled orders for machinery and equipment in July was nearly double the volume of unfilled orders in December 1961. In July the order backlog for metal-cutting machine tools exceeded 10 months and was nearly 25 percent longer than the length of the backlog in January and 50 percent longer than the length of the backlog in July 1965. The rate of unemployment in nonelectrical machinery industries was 2.1 percent in September and in August the length of the average workweek was 43.8 hours, well above the 41.3-hour average for all manufacturing industries. Producers, unable to find more skilled workers, evidently have increased costly overtime work.

TABLE 3.—*Factors affecting production of capital goods*

	Unfilled orders, machinery and equipment (seasonally adjusted) [1]	Order backlog of metal cutting machine tools [1]	Unemployment rates, nonelectrical machinery	Average workweek, machinery (seasonally adjusted)	Average hourly earnings, contract construction [2]	Department of Commerce composite construction cost index (1957–59 = 100)	Commercial and industrial construction (seasonally adjusted annual rate)
	Millions	*Months*	*Percent*	*Hours*			*Millions*
1961	$9,843	4.8	6.4	41.0	$3.20	104	$7,454
1962	9,828	3.9	3.7	41.7	3.31	107	7,966
1963	11,186	5.6	4.1	41.8	3.41	109	7,901
1964	13,367	6.3	3.0	42.4	3.55	112	8,978
1965	16,000	7.6	2.2	43.1	3.69	116	11,790
1965—July	14,700	6.8	2.2	42.8	3.65	116	10,789
August	14,982	7.3	2.4	42.5	3.69	116	11,212
September	15,152	7.6	1.9	42.8	3.75	117	12,298
October	15,369	7.6	1.7	43.3	3.77	117	12,124
November	15,606	7.7	2.0	43.4	3.75	117	12,997
December	16,000	7.6	1.8	44.2	3.77	118	14,267
1966—January	16,181	8.2	1.9	43.7	3.79	118	13,833
February	16,575	8.7	2.3	44.0	3.82	118	13,923
March	16,785	9.1	2.2	44.1	3.80	118	14,745
April	17,273	9.5	1.9	43.8	3.81	119	14,272
May	17,762	9.7	1.9	44.1	3.83	120	12,982
June	18,142	9.8	2.1	44.1	3.83	121	13,891
July	18,683	10.2	1.4	43.3	3.85	122	[3] 13,014
August	[3] 18,978	[3] 10.5	2.0	43.8	3.88	122	([4])
September	([4])	([4])	2.1	44.3	3.96	([4])	([4])

[1] Annual figures are for Decembers of years indicated.
[2] Preliminary.
[3] Not available.

Sources: U.S. Bureau of the Census, Department of Commerce; U.S. Bureau of Labor Statistics, Department of Labor.

With the volume of demand exceeding the capacity of the machinery and equipment industries, prices have risen. This is shown clearly in table 4. The wholesale price index for construction machinery and equipment in July was 3.1 percent above the level of July 1965, the index for metalworking machinery was 6.0 percent above the level of July 1965, and the index for general purpose machinery was 5.1 percent above the level of July 1965. These rapid price increases, which on average have exceeded the increase in the overall wholesale price index, can be contrasted with the relative stability in the prices of such equipment which existed in the years 1961 through 1963.

TABLE 4.—*Wholesale price indexes of machinery and equipment*

[1957-59=100]

	Machinery and equipment			Metalworking machinery and equipment		Electrical machinery and equipment	
	Construction	Metalworking	General purpose	Metalworking presses	Precision measuring tools	Wiring devices	Transformers and power regulators
1961	107.5	107.0	102.8	104.6	106.8	99.5	88.8
1962	107.8	109.3	103.3	106.0	109.4	99.7	85.1
1963	109.6	109.8	103.8	107.3	109.5	98.9	79.6
1964	112.4	112.6	104.4	110.7	111.7	100.7	78.7
1965	115.3	116.9	105.1	119.0	115.4	103.1	77.6
1965: July	115.3	116.5	104.7	117.7	115.9	103.6	77.0
1966:							
January	116.9	119.8	106.8	122.0	117.5	104.4	76.7
February	117.5	121.0	106.8	123.4	121.6	107.4	77.8
March	117.9	121.1	107.3	123.4	124.5	109.0	78.8
April	118.5	121.2	108.5	123.4	124.6	109.0	79.3
May	118.9	122.5	109.3	124.7	124.4	110.5	80.8
June	118.9	123.5	109.8	130.5	124.4	109.6	81.3
July	118.9	123.5	110.0	130.5	124.5	109.7	81.3
August	118.9	124.0	110.6	130.5	124.5	109.7	81.6
September	119.2	125.0	111.1	133.1	124.5	109.7	81.5

Source: U.S. Bureau of Labor Statistics.

Similar pressures have also been evident in the field of commercial and industrial construction. The boom conditions in this sector of the construction industry stand in sharp contrast to conditions in the field of owner-occupied residential housing. Table 3 indicates that in March and April the seasonally adjusted annual rate of commercial and industrial construction was nearly twice the volume of such construction in 1961. In July, the annual rate of construction was 21 percent above the July 1965 level. This sharp increase in activity has been accompanied by rising costs. The Department of Commerce composite construction cost index in July was 4 percent above its level in July of 1965 and 11 percent above the average level for the year 1963.

Inflationary pressures must be moderated

The inflationary pressures still evident in the capital goods industries despite earlier policy actions to restrain inflation must be moderated lest they endanger the continuation of rapid economic growth. If allowed to intensify, the distortions produced by the boom in business investment spending and severe monetary stringency will

threaten the balance in the economy which is so essential to steady and rapid growth. Overexpansion in the capital goods industry, which would become evident following the inevitable abatement of overstimulated demand for plant and equipment, most likely would lead to severe cutbacks in investment plans which would threaten termination of our present economic expansion. The rise in the prime interest rate to 6 percent—now the highest rate since 1930—the sharp decline in owner-occupied residential housing, and the boom in plant and equipment spending are reminiscent of the type of imbalances that have so often in the past brought and end to economic expansion. In this respect it is important to note that the share of nonresidential fixed investment in gross national product has risen from 9.2 percent in 1963 to 10.7 percent in the first half of 1966. Such a high level of investment has rarely provied sustainable in the past. For example, during the 1956–57 boom in investment spending, which preceded the recessions of 1958 and 1961, nonresidential fixed investment was 10.5 percent of the gross national product.

The application of fiscal restraints will help to keep the recent rate of increase in prices from accelerating and developing into a serious wage-price spiral. Moreover, restraining inflation now will help to insure that the fiscal burdens imposed by the conflict in Vietnam are distributed in a fairer and more equitable manner.

The adoption of policies which help calm the overheated pace of business investment spending also should reduce pressures for further monetary restrictions and will promote the early relaxation of existing restrictions. A decline in the demand for loans to finance investment spending will encourage an increase in the flow of funds to other sectors of the money market. In particular, more funds will be made available for mortgages on single family homes. Home buyers and consumers who purchase articles on the installment plan will benefit from the greater availability of credit and from lower interest rates. Business firms too, of course, will benefit if the cost of borrowing is reduced.

The Secretary of Commerce has pointed out that the accumulation of order backlogs and the rising prices which have accompanied them have encouraged domestic equipment buyers to look to foreign sources while domestic producers of such equipment, swamped with orders from domestic purchasers, have been unable to expand export sales. The results are shown in tables 5 and 6. Between 1962 and 1965 exports of capital equipment by U.S. producers increased in value by 52 percent but the value of imports of such equipment increased by 87 percent. This trend intensified in the first 6 months of this year. During this period, exports of U.S. capital equipment exceeded exports in the first half of 1965 by 13 percent but imports exceeded imports in the first half of 1965 by 44 percent. Several dramatic examples from particular industries also can be cited. For example, compared with the first half of 1965, in the first half of 1966 agricultural machinery and tractor imports rose 33 percent while exports fell 1 percent, metalworking machinery imports rose 89 percent while exports rose by only 1 percent, and imports of electrical power machinery and switchgear rose 55 percent while exports rose less than 1 percent.

TABLE 5.—*U.S. exports of capital equipment, 1962–65 and January–June 1965 and 1966*

[In millions of dollars]

	1962	1963	1964	1965	January–June 1965	January–June 1966		
						Value	Change from January–June 1965	
							Value	Percent
Capital equipment, total	6,514	6,842	7,966	9,871	4,860	5,472	+612	+13
Aircraft engines	(1)	(1)	(1)	256	121	144	+23	+19
Other engines and power generating machinery, nonelectrical	(1)	(1)	(1)	586	212	289	+77	+36
Agricultural machinery and tractors	521	605	825	865	467	464	−3	−1
Office machines	323	360	434	470	226	269	+43	+19
Metalworking machinery	464	371	408	332	165	166	+1	+1
Textile machinery	197	187	228	207	65	82	+17	+26
Construction, excavating, and maintenance equipment	(1)	(1)	(1)	322	165	161	−4	−2
Pumping equipment	94	104	110	143	68	89	+21	+31
Materials handling equipment	(1)	(1)	(1)	334	166	182	+16	+10
Power machinery and switchgear	264	326	356	472	247	248	+1	+(2)
Telecommunication broadcasting equipment	405	446	364	299	147	158	+11	+7
Aircraft, civilian	323	248	287	478	220	305	+85	+39
Parts and accessories for aircraft	(1)	(1)	(1)	310	171	156	−15	−9
Trucks, nonmilitary	227	268	306	279	136	152	+16	+12
Parts and accessories, automobile	641	731	864	992	489	570	+81	+17
Professional, scientific, and controlling instruments	319	348	377	480	231	276	+45	+19
All other capital equipment	2,736	2,848	3,407	3,380	1,564	1,761	+197	+13

[1] Data not available.
[2] Less than 0.05 percent.

NOTE.—Shifts in commodity classification in 1964 and 1965 disrupted comparability of data for some items.

Source: Department of Commerce.

TABLE 6.—*U.S. imports of capital equipment, 1962–65 and January–June 1965 and 1966*

[In millions of dollars]

	1962	1963	1964	1965	January–June 1965	January–June 1966		
						Value	Change from January–June 1965	
							Value	Percent
Capital equipment, total	848	935	1,161	1,587	751	1,080	+329	+44
Aircraft engines	11	5	7	20	9	15	+6	+67
Internal combustion engines other than automotive	7	21	89	131	60	84	+24	+40
Agricultural machinery and tractors	152	172	195	249	132	176	+44	+33
Office machines	85	98	104	136	65	90	+25	+38
Metalworking machinery	41	48	40	63	27	51	+24	+89
Textile machinery	40	46	58	78	35	60	+25	+71
Power machinery and switchgear	25	22	41	67	29	45	+16	+55
Aircraft and parts	123	91	83	141	65	132	+67	+103
Trucks	14	16	7	17	4	30	+26	+650
All other capital equipment	350	416	537	685	325	397	+72	+22

Source: Department of Commerce.

Action to restrain demand for machinery and equipment thus will have a favorable impact on the balance of payments by reducing the demand for imports and by helping to forestall the loss of export sales that will occur if the prices of capital goods continue to rise. In the short run, the favorable impact of this development will more than outweigh any adverse impact on the balance of payments attributable to a reduction in the rate of modernization of some sectors of U.S. industry.

The impact of this bill

This bill as a part of an overall program, including the reduction of at least $3 billion in Government expenditures, will help restrain inflationary pressures by suspending for 15 months the investment credit for machinery and equipment and accelerated depreciation on buildings. Suspension of accelerated depreciation on buildings whose construction is begun during the suspension period complements the suspension of the investment credit. Without overlapping, the two measures combine to apply fiscal restraint over a broad sector of the market for investment goods.

By increasing the cost of items ordered, acquired, or constructed during the suspension period, the bill will reduce the potential returns from prospective investments and will discourage marginal investments. This effect will be intensified by the fact that the investment credit will be available for machinery and equipment, ordered and acquired, or constructed after the suspension period. This effect is also intensified by the fact that accelerated depreciation will be available with respect to buildings whose construction is begun after December 31, 1967.

It is the impact on the rate of return on prospective investments rather than the revenue gain to the Government which is the most important feature of this bill from the standpoint of anti-inflationary fiscal policy. Orders for new machinery or equipment will be, and in some cases have already been, reduced relative to the large volume evident in recent months. The prompt reduction in orders will result in a decline in the size of producers' order backlogs. This will encourage producers to return to normal production schedules by reducing overtime; they will also reduce their orders for supplies and materials. These developments will lessen the pressures which have tended to produce inflationary price and wage increases in the machinery and equipment industry, commercial and industrial construction industry, and related industries.

Suspension of the investment credit increases the cost to business firms of all goods which now qualify for the credit. This increase in cost ranges from 2.4 percent in the case of machinery and equipment with an expected useful life of 4 to 6 years to 7.5 percent in the case of machinery and equipment with an expected useful life of 8 years or more. With respect to buildings, the use of accelerated depreciation methods currently provides the owners of new buildings with a benefit equivalent to at least 4 percent of the cost of the building. It is particularly worth noting that these increases in cost are temporary and can be avoided by postponing orders until after the termination of the suspension period. The bill therefore offers businessmen a strong inducement to defer investment projects until after the suspension period is terminated.

The immediate effects on economic activity which stem from a reduction in orders of capital goods are of prime importance from the point of view of restraining inflationary developments. In appraising the bill, attention should therefore be focused primarily on these effects and not on the manner in which corporate tax liabilities will be affected by the suspension. The investment credit and accelerated depreciation deductions affect tax liabilities, as a rule, only after the economic activity resulting from the production of a machine or building has been completed.

The reduction in new orders for machinery, equipment, and buildings which will result from this bill will tend to moderate the expansion in plant and equipment expenditures, and by preventing excesses, will tend to forstall an economic downturn in the near future. Moreover, the bill is likely to have a sigificant impact in reducing the demand for credit by business, with the result that pressures on interest rates will be eased and more funds will become available to finance home mortgages. To the extent that the bill suceeds in preventing further increases in interest rates or in promoting a reduction in interest rates, business borrowers themselves will benefit. The reduction in interest costs to such borrowers will partially offset the effect of suspending the investment credit and accelerated depreciation with respect to buildings. By moderating the domestic demand for machinery and equipment, the bill will strengthen the balance of payments in the short run. In view of the relatively brief suspension period, over the long run the competitive position of U.S. exports will continue to benefit from the availability of the investment credit.

While the bill is expected to have a significant anti-inflationary effect, it will not be of such a magnitude as to incur the risk of promoting a recession. The bill will have a marginal effect on the economy but an effect which should direct it toward the path of full employment economic growth without price inflation.

If military requirements in southeast Asia should decrease before January 1, 1968, or if for some other reason it should become apparent that suspension of the investment credit and suspension of the use of the accelerated depreciation methods with respect to buildings are no longer necessary to restrain inflation, the Congress can promptly terminate the suspensions. The administration has also indicated that it would recommend terminating the suspension period before January 1, 1968, under such conditions.

Revenue effect

It is not clear how the suspensions of the investment credit and accelerated depreciation will change budget receipts. There would appear to be an increase in revenue, at a given level of investment. However, the suspension can be expected to reduce investment expenditures which will reduce incomes of some sellers of investment goods and thereby reduce revenues.

There is value in describing the hypothetical revenue effect of the bill, however, given the current level of investment expenditures. This, therefore, is only a description of the magnitude of the tax changes effected by this bill. The actual revenue effect will depend upon how business firms modify their investment plans in response to these suspensions.

It is estimated that suspension of the investment credit as provided in H.R. 17607 as amended by your committee will increase receipts in the fiscal years 1967 through 1970 by $1,650 million (as contrasted to $1,950 million under the House bill). Of this total, about $300 million is expected to be received in the fiscal year 1967 and $700 million in the fiscal year 1968. The relaxation of the existing limits provided by this bill on the amount of investment credit which may be claimed in any one taxable year will partially offset the effect of suspending the credit as far as the fiscal years 1968 through 1970 are concerned. This provision will reduce tax receipts in those 3 fiscal years by $850 million. In the fiscal year 1968, the relaxation in the limitation will reduce receipts by $125 million, reducing the net effect of the investment credit provisions to an increase in receipts in that year of $575 million. Suspension of accelerated depreciation with respect to buildings costing $100,000 or more constructed during the suspension period will increase receipts during the fiscal years 1968 through 1970 by an estimated $95 million. The effect in the fiscal year 1968 of this latter provision will be an increase of $10 million.

III. GENERAL EXPLANATION

A. Suspension of the investment credit (sec. 1 of the bill and sec. 48 of the code)

1. Present law

Existing law provides a credit (code sec. 38) against tax liabilities with respect to "qualified investment." The credit, generally equal to 7 percent of qualified investment, may be taken with respect to investment in most types of tangible personal property and in certain limited types of real property where the property is used directly in manufacturing, production, transportation, etc. Qualified investment is investment in either new or, to a limited extent ($50,000), used property of the type referred to above with a useful life of 4 years or more. In the case of such property with an expected useful life of 4 to 6 years, qualified investment is limited to one-third of the investment in the property and in the case of such property with an expected useful life of 6 to 8 years, qualified investment is limited to two-thirds of the investment in the property. Qualified investment includes the entire investment in this property only if it has an expected useful life of 8 years or more. In the case of most public utility property the investment credit is limited, in effect, to 3 percent of qualified investment.

The amount of the 7 percent investment credit (or, where applicable, the 3 percent credit) which may be claimed in any one taxable year is limited to the tax liability of that year if the liability prior to the application of the credit does not exceed $25,000. If the tax liability, prior to the application of the credit, exceeds $25,000, the credit which may be claimed is limited to $25,000 plus an amount equal to 25 percent of the tax liability in excess of $25,000. Credits which are unused as a result of this limitation may be carried back to the 3 prior taxable years and, if not used up in this manner, carried forward to the succeeding 5 taxable years. In computing the applicable amount of a carryback or carryforward, the investment credit

remains subject to the limitation outlined above and any investment credit earned during the taxable year must be used before any applicable carryback or carryforward.

2. Explanatioin of provision in general

The bill temporarily suspends the investment credit. The suspension applies to otherwise qualified investment in—

(i) Property acquired during the suspension period;

(ii) Property ordered during the suspension period; and

(iii) Property whose construction, reconstruction, or erection begins during the suspension period.

An exception (explained in part C below) is made with respect to property acquired or constructed pursuant to a contract binding on the taxpayer at the time the suspension became effective. An exception is also made for up to $25,000 of property ($15,000 under the House bill) ordered, acquired or constructed during the suspension period which would otherwise be classified as ineligible for the credit as the result of the suspension provided in this bill. The property covered by these exceptions will continue to be eligible for the investment credit.

The suspension period begins on October 10, 1966 (September 9 in the House bill), and ends on December 31, 1967.

The suspension is applied both on the basis of orders for property made during the suspension period, and also on the basis of the construction of property during the suspension period, to insure that the measure will achieve the objective of restraining inflation. If the suspension applied with respect to installations made during the suspension period it would have little or no impact on orders placed during the suspension period in cases in which delivery and installation would not take place until, or could be deferred to, 1968 or later years. In view of the current length of order backlogs in segments of the equipment industry and of the length of time required for the construction of large items of capital equipment, a suspension based on installations would, therefore, have relatively little effect on the volume of orders placed during the suspension period. Production is largely keyed to orders, not deliveries, so that a suspension based on installations would have relatively little impact on the current demand for resources.

The fact that the suspension of the credit applies to orders and commitments as well as construction does not, of course, imply any change in the basic operation of the investment credit. Taxpayers will continue to claim any amount of credit due them only after delivery or installation of the property.

As previously indicated, an exception to the general rule outlined above is available in the case of property acquired during the suspension period under the terms of a binding contract entered into by the taxpayer prior to the beginning of the suspension period. The investment credit will continue to apply to such property. An exception also applies to property constructed, reconstructed, or erected by the taxpayer if such construction, etc., was begun before the beginning of the suspension period. This exception to the general rule is required in fairness to taxpayers who were unaware of the forthcoming suspension of the credit at the time they entered into agreements

to construct or acquire property eligible for the investment credit which they cannot now cancel without liability for damages. This rule is explained in part C below.

3. Effective date of October 10, 1966

As indicated above, your committee has moved the effective date forward to October 10, 1966, from the September 9, 1966, date in the House bill. The committee action eliminates a retroactive feature of the House bill and instead makes the bill effective when the Committee of Finance reported it. In view of this consideration, your committee made the effective date coincide with the date it began action on the the bill.

4. Exemption of up to $25,000 of investment

Your committee's bill, at the election of the taxpayer, exempts from suspension of the investment credit up to $25,000 of investments made during the suspension period which would otherwise be ineligible for the investment credit under the terms of this bill. The exemption applies to the property ordered, acquired or constructed during the entire suspension period, but only with respect to property which is to be used in the taxpayer's own business. In the case of partnerships, the $25,000 limitation is applied at both the partner and partnership levels (e.g., if a partnership elects to take the full investment credit of $25,000, a 50-percent partner could make such an election only with respect to an additional credit of $12,500).

The pressure for loans to finance significant increases in plant and equipment spending stems largely from the Nation's larger business organizations. The $25,000 exemption will be a negligible factor in the investment decisions of such organizations. It will not be negligible, however, to small business enterprises and farms, many of which presently have difficulty raising funds because of existing monetary restrictions.

Furthermore, investment by small business and farms makes up a relatively small percentage of total investment in machinery and equipment.

Your committee concurred with the reasoning of the House in providing for this exception to the suspension of the investment tax credit, but it raised the limit of the exception to $25,000 from the $15,000 contained in the House bill. The committee believes that $25,000 is a more appropriate limit for small business enterprise and independent farmers. The lower limitation would not cover some single units of equipment that farmers and various small businessmen purchase. The action also is consistent with long standing public policies to foster small business and farming.

5. Exemption of water and air pollution control facilities

An amendment adopted on the floor of the House specifies that water and air pollution control facilities are, under certain conditions, not to be considered suspension period property even though constructed or ordered during the suspension period. Thus, facilities of this nature will continue to remain eligible, for the investment credit.

The exception is provided in recognition of the importance of stimulating private industry to undertake expenditures for facilities which will help to abate water and air pollution. There is a clear need to step up efforts to purify the air we breathe and the water in our streams and lakes.

Suspension of the credit, even for a short time, would discourage private efforts to abate water and air pollution and would simply impose a larger direct burden on the government.

This provision of the bill specifies that water and air pollution control facilities will not be treated as suspension period property if they are used primarily to control either water pollution or atmospheric pollution by removing, altering, or disposing of pollutants. The facilities must conform to the State program or to State requirements in regard to the control of water or air pollution and they must be in compliance with the applicable regulations of Federal agencies and with the general policies of the United States, in cooperation with the States, for the prevention and abatement of water and air pollution. Certification to this effect must be made by the State water or air pollution control agency, as defined in the Federal Water Pollution Control Act or the Clean Air Act. In addition, such a facility must be constructed or acquired in furtherance of Federal, State, or local standards for the control of water or air pollution.

6. Exemption of railway freight and passenger cars

Your committee provided an exemption, not provided in the House bill, for railway freight and passenger cars. Such equipment will therefore remain eligible for the investment credit even though it is constructed or acquired during the period from October 10, 1966, to December 31, 1967. Locomotives and other self-propelled cars, and railway equipment other than freight or passenger cars will be affected by the suspension of the investment credit.

The shortage of boxcars and other freight cars and the serious implication this shortage has for the economy are well known. As recently as May 26 the President commented on the seriousness of the freight car shortage and stated that it should not be tolerated. The administration also excepted the railway industry from the request made in April that business reconsider capital expenditure programs and, wherever feasible, postpone part or all of such programs.

It has been pointed out to your committee that the 7-percent investment credit has been and continues to be an important incentive to the construction of needed railway cars. Withdrawal of the investment credit, even for a short period, would not be in the national interest. The slight effect such a withdrawal would have in lessening inflationary pressures in the capital goods industries would be more than offset by the adverse effect which a continuation of the present shortage of railway cars would have. The latter could intensify a transportation bottleneck of serious proportions, particularly with regard to the transportation of grain.

7. Procedure for taking suspended credits into account in computing maximum limitation

In 1966 and in subsequent years, some investment credits will be allowed (for example, where binding orders were placed before October 10, 1966), while others will not because the property was either acquired or ordered during the suspension period. In cases where property ordered during the suspension period is not delivered until 1968 or subsequent years, even in these years there may, therefore, be

investment which is disallowed for purposes of the investment credit. The bill establishes a priority as between the "disallowed investment credits" and the "allowed investment credits." The bill, in effect, provides that the first investments to be taken into account for purposes of the maximum limitation are the disqualified investments with respect to property either acquired or ordered during the suspension period.

This effect is achieved by reducing the maximum investment credit which may be claimed in any taxable year ending after October 9, 1966, by the amount of the credit which would have been allowed for the taxable year involved but for the suspension of the investment credit as provided by this bill. The next credits for investments which will be applied against the maximum limitation are those earned during the current year. Next, as under existing law, carryovers of unused credits from prior years will be allowed to the extent of any remaining portion of the maximum limitation. For purposes of this provision, suspension period property in effect is deemed to be owned by the lessee.

Reducing the maximum limitation first by the amount of credit for disqualified investments attributable to the suspension period is necessary to prevent taxpayers in some cases from claiming as large investment credits during a particular year as would be true in the absence of the suspension of the investment credit. To do otherwise would substantially lessen the impact of this bill with respect to investments attributable to the suspension period. This means that the bill would have a lesser impact in diminishing inflationary pressures than would otherwise be the case.

8. Property to equip new UHF television stations

Another problem brought to the attention of your committee relates to property necessary for the operation of an ultrahigh frequency television broadcasting station where authorization for the station had been granted by the Federal Communications Commission before October 10, 1966. Your committee provided that the investment credit is not to be suspended in these cases where the taxpayer had entered into a binding contract for the acquisition of the broadcasting transmitter before the beginning of the suspension period, but only as to property which is constructed, et cetera, in accordance with the authorization (as it may be modified). In your committee's view this is a type of commitment which should be honored for purposes of the credit. It does not apply to property constructed, et cetera, for a station which had commenced operations before the beginning of the suspension period.

9. Effective date

This provision of the bill applies to taxable years ending after October 9, 1966.

B. Limitation on use of certain methods of depreciation (sec. 2 of the bill and sec. 167 of the code)

1. Present law

The following methods of depreciation are permitted under present law (code sec. 167) with respect to tangible property acquired when new by the taxpayer, or constructed by him for his use, after December

31, 1953, provided the property has an expected useful life of 3 years or more:

(*a*) The straight-line method;

(*b*) The declining balance method at a rate not to exceed twice the applicable straight-line rate;

(*c*) The sum of the years-digits method; and

(*d*) Any other consistent method which does not provide deductions during the first two-thirds of the useful life of the property which exceed the deductions allowable under the method described in (*b*).

Under the double declining balance method a rate equal to twice the straight-line rate is applied to the unrecovered basis of the property. This is a basis which each year is reduced by the depreciation taken in the prior year. The sum of the years-digits method is a method similar to the double declining but achieving a somewhat faster writeoff and leaves no unrecovered cost.

In the case of property acquired or constructed before December 31, 1953, or property acquired after that date from the original or a subsequent owner, the methods of depreciation described in (*b*), (*c*), and (*d*) above may not be used. Depreciation in such cases may be computed under a reasonable and consistently applied method of depreciation including such methods as the straight-line method, the declining balance method at a rate not in excess of 150 percent of the applicable straight line rate and, under appropriate circumstances, the unit of production method.

In comparison with the straight-line method and the declining balance method at a rate of 150 percent of the applicable straight-line rate, the other methods of depreciation listed above provide depreciation deductions during the early years of the asset's life that are substantially larger. For example, in the case of an asset with an expected useful life of 10 years, use of the declining balance method at a rate twice that of the straight-line rate permits the recovery through depreciation deductions of roughly two-thirds of the investment in the property in the first half of its useful life while the use of the sum of the years-digits method permits the recovery of nearly three-fourths of the investment in the same period. Use of the declining balance method at a rate equal to 150 percent of the applicable straight-line rate in the same example permits the deduction of only 56 percent of the asset's cost in the first half of its expected useful life. Under the straight-line method, of course, only one-half of the amount invested can be recovered in the first half of the asset's useful life.

2. Explanation of provision

Bill provides that the accelerated methods of depreciation may not be used with respect to buildings (other than property which would be eligible for the investment credit but for the suspension): (a) which are ordered during the suspension period or (b) whose construction, reconstruction, or erection begins during the suspension period. It prohibits the use of all methods of accelerated depreciation allowable under present law that provide deductions in excess of 150 percent of the applicable straight-line rate. However, as indicated further be-

low, the accelerated depreciation during the suspension period will remain available for an investment of up to $100,000 in buildings.

The suspension period begins on Oct. 10, 1966, (September 9 under the House bill), and ends on December 31, 1967. In this case also, as in the case of the investment credit suspension, an exception is made for buildings whose construction was begun prior to the beginning of the suspension period, or whose construction was fixed under the terms of a contract binding on the taxpayer at that time, and at all times thereafter. The same definition of a binding contract will apply in this case as in the case of the suspension of the investment credit. (See part C below.)

This provision, in effect, prohibits the use of the accelerated methods of depreciation with respect to buildings whose construction commences during the suspension period or which are ordered during that period. The provision complements, but does not overlap, the suspension of the investment credit. Accelerated depreciation with respect to buildings offers much the same tax incentive to construct such property as the investment credit offers with respect to property eligible for it. If this provision were not included in the bill, some investment funds would be shifted to this type of construction as a result of the suspension of the investment credit and inflationary pressures in this sector of the construction industry would be intensified. Furthermore, this provision will release resources for the construction of owner-occupied residential dwellings.

With respect to buildings affected by this provision, the same methods of depreciation may be used as are now available under regulations issued by the Internal Revenue Service with respect to property constructed before December 31, 1953, and to property acquired by a taxpayer who is not the original user of such property. The allowable methods will therefore include the straight line method, the declining balance method at a rate not to exceed 150 percent of the applicable straight line rate and, under appropriate circumstances, the unit of production method.

In no event will the accelerated forms of depreciation specified in the code (the double declining balance and sum of the years-digits methods) become available for buildings built or ordered during the suspension period. If, upon termination of the suspension period, accelerated depreciation could be taken on all buildings constructed during that period, the provision would have little or no moderating effect on the volume of orders for buildings since the length of the suspension period is so short relative to the expected useful life of most buildings.

3. Exception of up to $100,000 of construction

Your committee amended the House bill to permit accelerated depreciation during the suspension period for an investment in a building or buildings costing not more than $100,000. The taxpayer, however, is allowed only one such exception during the suspension period.

This amendment generally is parallel for buildings to the $25,000 exception from the suspension of the investment tax credit on personal property. (However, the exception in this case is available only if the total cost of the building or buildings does not exceed $100,000.) The limitation is low enough to avoid encouraging construction of

major commercial and industrial structures, an area presently subject to inflationary pressures. It will encourage construction of plants for small businesses, retail stores, and small apartment houses, sectors of the construction industry that are less active now. This area of construction would include small apartment buildings, and their erection during the suspension period will help to offset some of the house shortage resulting from the 1966 recession in housing construction.

4. Effective date

This provision of the bill is to apply to taxable years ending after October 9, 1966.

C. Rules common to suspensions of investment credit and accelerated depreciation

1. Suspension period property (secs. 1 and 2 of the bill and secs. 48(h)(2) and 167(i)(1) of the code)

The bill provides analogous rules in the case of the investment credit and in the case of the accelerated depreciation provisions in determining whether machinery, equipment, and buildings are to be treated as constructed (reconstructed or erected) or acquired during the suspension period (Oct. 10, 1966, through Dec. 31, 1967) and whether they are, therefore, ineligible for the investment credit or the accelerated depreciation, as the case may be.[1] Certain exceptions to these rules are provided where binding contracts were entered into before the beginning of the suspension period (discussed in par. No. 2 below) and other special rules also are discussed subsequently.

Generally, where the physical construction (or reconstruction or erection) begins during the suspension period the machinery and equipment is not eligible for the investment credit and the building is not eligible for accelerated depreciation. The investment credit is not to be available where machinery and equipment is acquired by the taxpayer during the suspension period even though it was constructed at an earlier time. This rule does not apply, however, in the case of buildings. Transfers of buildings constructed before the suspension period are unaffected by the suspension of accelerated depreciation provided by this bill (since in any case they are ineligible for these forms of accelerated depreciation because under present law these depreciation methods are available only to the first user of the building).

In addition to applying to construction beginning during the suspension period and certain acquisitions during this period, the bill also suspends the investment credit and the application of the ac-

[1] The term "machinery and equipment" is used here with reference to property eligible for the investment credit and the term "building" is used when the reference is to property for which only accelerated depreciation is available. While there are exceptions to this, in that some limited forms of buildings are eligible for the investment credit, and some machinery and equipment is not eligible for the credit, this division is applicable in the great bulk of cases. Therefore, the use of these terms in this manner illustrates the more likely situation and makes a simpler explanation possible. The accelerated depreciation methods referred to here are only the new forms first made available in the 1954 code. Accelerated depreciation is, of course, available not only for depreciable property not eligible for the investment credit but also for property eligible for the investment credit. The bill, however, in no case removes accelerated depreciation in the case of property which would be eligible for the investment credit but for the suspension. As a result, references in this report to denial or allowance of accelerated depreciation refer only to accelerated depreciation with respect to buildings not eligible for the investment credit. A machine or equipment purchased or ordered during the suspension period will continue to qualify for accelerated depreciation.

celerated depreciation provisions in the case of orders placed during this period for construction, even though manufacture and delivery or completion of the machinery, equipment or building may occur after the end of the suspension period. This is designed to remove an incentive for increases in inventories of parts or components for future assembly and delivery for orders placed, or the beginning of construction projects, during the suspension period. With respect to orders for deliveries after the termination of the suspension period, much of the anti-inflationary effect of suspending these provisions would be lost were the inducement for such work during the suspension period not lessened by making these items or projects ineligible for these special tax provisions. This, of course, in the case of machinery and equipment, is not intended to apply in cases where the items inventoried for resale are not subject to orders. On the other hand, however, items held directly or indirectly pursuant to orders during the suspension period are to be ineligible for the investment credit or accelerated depreciation. In the case of orders of machinery and equipment placed during the suspension period, the investment credit is not to be available even though manufacture is begun and delivery is made with respect to these orders after the end of the suspension period.[2]

A House floor amendment made sure that this same rule applied in the case of the leased tangible personal property, where it was constructed or reconstructed by the taxpayer. This amendment, which your committee's bill retains, provided that where such property is leased after the end of the suspension period (and the first use of the property is after the end of the suspension period) if the construction or reconstruction and lease were not pursuant to an order placed during the suspension period and the investment credit is taken by the lessee, this will not be considered as suspension period property (and therefore will be eligible for the credit). This rule is designed to match the inventory rule already discussed.

Physical construction of a building begins for purposes of the bill when actual work on it commences—that is, when work commences on the digging of the footings of a building or the driving of foundation piles into the ground. Preliminary work, such as clearing a site, test drilling to determine soil conditions, or excavation to change the contour of the land (as distinct from excavation for footings) does not constitute the beginning of the physical construction, reconstruction, or erection of a building. Where physical construction has begun before the beginning of the suspension period, accelerated depreciation is to be available for the completed building (including structural components necessary to the operation of the building, such as elevators, furnaces, and central air conditioners) but an investment credit is not available for machinery and equipment used in the building for a manufacturing process, and so forth, which may be carried on there (unless one of the exceptions described below applies). If the physical construction has commenced before the beginning of the suspension period, whether the construction is performed by the tax-

[2] In this connection, payments made to the Federal Aviation Agency by an airline to assist the Government in defraying the development costs of a supersonic transport are not to be considered an "order" even though the payment may entitle the airline to a delivery priority when the plane has been developed.

payer or by some one else under a contract with him, the entire building is to be eligible for the accelerated depreciation. However, as indicated below, where a contract has been let for footings, for example, but not for the entire building, accelerated depreciation is to be available only with respect to this portion of the value of the building and not the whole building if construction has not physically commenced. On the other hand, if a person is in effect his own general contractor and has let a contract for the footings, he will be treated as having begun construction if the person who contracted to build the footings has actually commenced physical construction of this item.

In the case of a machine or equipment, similar rules to those set forth above with respect to real property are to apply. The construction of a machine or equipment is to be considered as begun when work of a significant nature has begun with respect to the machinery or equipment. Thus, if the foundation or installation is significant and this has begun, the construction of the machine or equipment will be considered to have begun. If manufacturing on important parts of the machine has begun, construction will be considered as commenced. Similarly, if assembly of parts (other than for inventory) has begun, this too will indicate the beginning of the construction of the machine or equipment. However, construction on a machine or equipment will not be considered as begun if work has begun only on minor parts or components of the machine or equipment. As indicated in the House report, for example, in the case of the construction of a transistor to be used in a computer, the beginning of the construction of the transistor will not mean the beginning of the construction of the computer.

It has come to the attention of your committee that a number of companies may have difficulty in identifying, under their accounting systems, whether a particular item placed in service was acquired before October 10, 1966, or pursuant to contracts that were binding on that date. The problem arises where the companies regularly acquire (or manufacture themselves) and maintain a large stock of identical or similar pieces of property to be placed in service as needed. The accounting systems may not identify with respect to each item the date on which it was acquired or constructed (or the date on which the contract for its acquisition was entered into). In these situations, the companies are to assume that the first items put in service after October 9, 1966, were those they had on hand or under a binding contract on that date. This same rule is to apply at the end of the suspension period.

2. Binding contracts (secs. 1 and 2 of the bill and secs. 48(h)(3) and 167(i)(1) of the code)

Under the bill, the investment credit and accelerated depreciation are not suspended with respect to property which is constructed, reconstructed, erected, or acquired pursuant to a contract that was binding on the taxpayer at the close of October 9, 1966, and at all times thereafter. This provision applies only to contracts in which the construction, reconstruction, erection, or acquisition of property is itself the subject matter of the contract, and does not apply to a con-

tract with a person other than the builder or supplier under which the taxpayer becomes obligated to construct, reconstruct, erect, or acquire property. A supplier for this purpose need not be the person who manufactures the property which is being acquired, but may be a distributor or other type of middleman. (To the extent so-called third party leases and contracts are intended to be covered, see subsequent discussion.) Thus, a contract with a financial institution, a bond underwriter, or a labor union under which the taxpayer is obligated to acquire property is not covered by this provision.

Whether or not an arrangement between a taxpayer and a builder or supplier constitutes a contract is to be determined under the applicable local law. A contract for this purpose may be oral or written. However, in the case of an oral contract, the taxpayer must establish by appropriate evidence that the contract was, in fact, entered into. This may be done by memorandums, the conduct of the parties or other evidence that a contract was in fact entered into. State law as to the effect of "part performance," and as to when a seller has accepted an order will apply.

A binding contract for purposes of this provision exists only with respect to the property which the taxpayer is obligated to accept under the contract. Thus, when prior to October 10, 1966, a taxpayer had contracted to purchase a lathe but not the motor to run the lathe, the investment credit is denied under this rule only with respect to the motor (but see special 50-percent rule for machinery and equipment set forth below). In addition, where a contract obligates a taxpayer to purchase a specified number of items and also grants him an option to purchase additional items, the contract is binding on the taxpayer only to the extent of the items he must purchase. Similarly, where the taxpayer is bound under a contract to purchase either of two or more specified items, this rule applies only to the extent of the contract price of the least costly of the items which may be selected.

A contract may be considered binding on a taxpayer even though (*a*) the price of the item to be acquired under the contract is to be determined at a later date, (*b*) the contract contains conditions the occurrence of which are under the control of a person not a party to the contract, or (*c*) the taxpayer has the right under the contract to make minor modifications as to the details of the subject matter of the contract. These rules may be illustrated by the following examples:

A contract to buy a specified type, grade, and amount of steel, the price to be the market price on the day of delivery, may be a binding contract. A contract which is conditioned upon obtaining of a certificate of convenience and necessity from a public utilities commission may be a binding contract. Where, under a contract to purchase a machine tool, the purchaser has the right to modify the specifications for the tool to reflect current technological advances, the contract may be a binding contract. Similarly, where a contract contains a condition which is under the control of one of the parties to the contract and this party is obligated (either by the specific terms of the contract itself or by operation of State law) to use his best efforts to secure the occurrence of the condition, the existence of the condition in the contract does not prevent the contract from being one which is binding on the taxpayer. For example, if a contract to purchase equipment is conditioned upon thee supplier being able to supply the equipment

within a specified period of time and the supplier is obligated to use his best efforts to satisfy this condition, the contract may be a binding contract. Likewise, a contract for the purchase of real property which is conditioned upon the purchaser making his best efforts to obtain financing may be a binding contract.

On the other hand a contract which is binding on a taxpayer on October 9 will not be considered binding at all times thereafter if it is substantially modified after that date. A waiver of a right to cancel upon a price change is an example of a substantial modification.

A contract under which the taxpayer has an option to acquire property is not a contract that is binding on the taxpayer for purposes of this provision unless the amount paid for the option is forfeitable (if the taxpayer does not exercise his option), is to be applied against the purchase price of the property (if the taxpayer exercises his option) and then only if the amount paid for the option is not nominal. Similarly, a contract which limits the damages to be recovered, in the event of a breach by the purchaser, to the amount of a deposit or to liquidated damages is not a binding contract if the deposit or the liquidated damages are nominal in amount. In determining whether a deposit, or liquidated damages, or the amount paid for an option is nominal, the size of the deposit, etc., relative to the contact price of the property which is the subject matter of the contract is to be taken into account. If the deposits, etc., are a significant portion of the price of the item, the contract may be a binding contract. For example, a deposit of $50,000 by the developer of an urban renewal project in connection with a contract (which comes within the rules explained below in certain leases, etc., with third parties) to acquire land from a city at a price of $1 million is a significant portion of the contract price.

Where an order for the purchase of property may be canceled by the purchaser within a specified period of time, such as 90 days, the order is a contract binding on the purchaser if the period of time had expired before October 10, 1966, or had been terminated by partial performance with the buyer's consent. Similarly, the right of a buyer under a contract for the acquisition of property to cancel the contract if the seller raises the selling price (a so-called price escalation clause) does not prevent the contract from being binding on the buyer until the buyer becomes entitled to exercise his cancellation rights.

If a taxpayer who had entered into a contract for the construction of property prior to October 10, 1966, completes the contract himself because of the default of the other contracting party, the taxpayer is considered to have a binding contract to the extent that he was bound on the contract prior to the default.

There would not be a binding contract if the machinery, equipment, or building to be supplied is not specifically identified and determined before October 10, 1966. Thus, for example, if a financier has agreed with an airline to buy planes and lease them to the airline when requested (whether or not some maximum is provided), there is no binding contract as to those planes which were not requested before October 10. However, this is not intended to foreclose the allowance of the investment credit in the case of a contract to lease, which in all respects was binding on the lessor on or before October 9, 1966, where the lessee was not required to take a specified amount of the property

in question if the lessor retained the investment credit with respect to the property. In this case, the party having the investment credit has a binding contract.

3. Equipped building rule (secs. 1 and 2 of the bill and secs. 48(h)(4) and 167(i)(1) of the code)

Both the House and your committee realized that once construction on a building has begun, there are likely to be commitments which make it necessary to complete the building, as well as to acquire machinery, equipment and appurtenances necessary to the operation of the facility. Therefore, the bill lays down a rule which, in general, provides that where construction on a building has begun, before the beginning of the suspension period, and the cost of the building plus any machinery and equipment for it which has been ordered (under a binding contract) or constructed before the suspension period represents more than half of the entire cost of the building and planned equipment, the entire equipped building project and incidental appurtenances are to be eligible for the investment credit or accelerated depreciation, as the case may be. Where the costs incurred before the suspension period do not equal more than half the cost of the equipped building, each item of machinery and equipment and the building are to be treated separately (as provided in existing law) for purposes of determining whether the item qualifies for the investment credit or is suspension period property.

It is recognized, of course, that there are various types of commitments which are made before physical construction has commenced or a binding contract has been entered into which, although they occurred before October 10, do not result under the bill in the allowance of the investment credit or accelerated depreciation. In part, these were not taken into account because their varied nature makes it impossible to specify with certainty in the statute those cases where the investment credit and/or accelerated depreciation would be available and those cases where it would not. Moreover, in many of these cases involving earlier commitments, it is possible either to cancel the project or to postpone it which, of course, generally is desirable from the standpoint of the anti-inflationary effect on the economy.

The equipped building rule provided in the bill provides that the investment credit or accelerated depreciation is to be available with respect to the completed building, the equipment and machinery to be used in it, and also incidental machinery, equipment, and structures adjacent to the building (referred to here as appurtenances) which are necessary to the planned use of the building, where the following conditions are met:

(*a*) The construction (or reconstruction or erection) or acquisition of the building, machinery, and equipment was pursuant to a specific plan of a taxpayer in existence on October 9, 1966; and

(*b*) More than 50 percent of the adjusted basis of the building and the equipment and machinery to be used in it (as contemplated by the plan) was attributable to property on which either construction has begun before October 10 or which was acquired or under binding order before October 10.

In applying this 50-percent test, the machinery or equipment ordered or constructed before that date which are to be taken into account

include the cost of essential parts or components ordered subsequently which, under the special machinery and equipment rule (explained below), are to be eligible for the investment credit. This rule, of course, does not allow the taxpayer to add machinery and equipment with respect to a building under construction at will, since the building and equipment must be a part of a specific plan of the taxpayer in existence before October 10, 1966. While this plan may be modified to a minor extent after that date (and the property involved still come under this rule), nevertheless, there cannot be substantial modification in the plan if this equipped building rule is to apply. The plan referred to here must be a definite and specific plan of the taxpayer which, in one form or another, is available as evidence of the taxpayer's intentions.

The equipped building rule can be illustrated by an example where the taxpayer has a plan providing for the construction of a $100,000 building with $80,000 of machinery and equipment to be placed in the building and used for a specified manufacturing process. In addition, there may be other structures or equipment, here called appurtenances, which are incidental to the operations carried on in the building which are not themselves located in the building. Assume that the incidental appurtenances have a further cost of $30,000. These appurtenances might include, for example, an adjacent railroad siding, a dynamo or water tower used in connection with the manufacturing process, or other incidental structures or machinery and equipment necessary to the planned use of the building. Of course, appurtenances, as used here, could not include a plant needed to supply materials to be processed or used in the building under construction. In this case, if construction on the building had begun but no equipment had been ordered, and the appurtenances had not been constructed or placed under binding order, nevertheless, the entire equipped building and appurtenances would be eligible for the investment credit or accelerated depreciation, whichever is applicable. This can be seen by the following analysis of this example: the cost of the equipped building in this case was $180,000 and since construction on the building had commenced, the machinery and equipment, even though not under binding order, would be eligible for the investment credit as a result of this rule. This is true because the building cost represents more than 50 percent of the total $180,000. In this connection, it should be noted that the additional cost of the appurtenances, $30,000, is not taken into account for purposes of determining whether the percentage requirement is met. However, the investment credit or accelerated depreciation would be available with respect to these appurtenances since the 50-percent test is met as to the equipped building.

Although the above example is one in which the construction of the building had commenced while the machinery and equipment had not been ordered, in other cases the reverse may be true. If the machinery and equipment contracted for is the major portion of the total cost in such a case, the investment credit or accelerated depreciation is to be available with respect to the entire equipped building even though the construction of the building itself has not commenced. Thus, for example, had the cost of the machinery and equipment (including installation costs not yet incurred) in the example cited above been $120,000 instead of $80,000, and had this machinery and equipment

been contracted for whereas construction had not started on the building, nevertheless, the equipped building rule would apply and accelerated depreciation would be available on the building.

If the taxpayer had begun construction of a building which would cost $80,000 to house equipment which will cost $200,000, but had not acquired or contracted for the equipment, there will be no credit for the equipment. Similarly, if the taxpayer had purchased equipment which cost $90.000, but has neither contracted for nor begun the construction of a $210,000 building to house this equipment, accelerated depreciation will not be allowable for the building.

4. Plant facility rule (sec. 1 of the bill and sec. 48(h)(5) of the code).

Your committee has added a "plant facility" rule to the bill which is comparable to the equipped building rule (explained in par. No. 3 above) to provide for cases where the facility is not housed in a building.

Under modern practices many production facilities, which in the past were housed in buildings, are erected out in the open. This has been made possible by improved technology and is desirable in many of these cases for reasons of safety and economy. The plant facility provision added by your committee provides, in effect, two rules. The first of these rules is applicable where construction of the facility at the site had not commenced on October 9, 1966. The second rule covers the situation where such construction had commenced. Under the first rule, if a taxpayer, pursuant to a plan in existence on October 9, 1966, constructed, reconstructed, or erected a plant facility (or portion thereof) and more than 50 percent of the aggregate adjusted basis of the depreciable property which makes up the facility is attributable to either (1) property the construction, reconstruction, or erection of which was begun by the taxpayer before October 10, 1966. or (2) property the acquisition of which by the taxpayer occurred before that date, then all property of the type which is generally eligible for the investment credit which makes up the facility is not to be treated as suspension period property. This rule only applies if the plan under which the facility is constructed, et cetera, is not substantially modified after October 9, 1966, and before the facility is placed in service.

In determining whether the 50-percent requirement of this rule is met, installation costs and engineering costs which are capitalized and have been incurred prior to October 10, 1966, are to be taken into account. In addition, such costs which had not been incurred prior to that date but which are attributable to property construction, et cetera, of which had begun prior to October 10, or property which had been acquired prior to October 10 are to be taken into account for this purpose.

As in the case of the equipped building rule, property on order under a binding contract in effect on October 9, 1966 (and thereafter), is included in determining whether the facility meets the 50-percent requirement. The rules dealing with binding contracts (explained in par. No. 2 above) are applicable to this provision. Similarly, property which is not suspension period property under the special machinery and equipment rule (explained in par. No. 5 below) is to be included in determining whether the facility meets the 50-percent requirement.

The new provision defines a plant facility to be a facility which meets the following requirements. The facility must not include a building, other than buildings which constitute an insignificant portion of the facility. In addition, it must be (1) a self-contained, single operating unit or processing operation, (2) located on a single site, and (3) identified on October 9, 1966, in the purchasing and internal financial plans of the taxpayer as a single unitary project.

The fact that the facility does not produce a commercially marketable product is irrelevant in determining whether or not a particular facility is a plant facility for purposes of this provision. Furthermore, the fact that a single operating unit or processing operation is connected by pipes, conveyor belts, et cetera, to one or more other units or processing operations in an integrated processing or manufacturing system does not cause the whole system to be a plant facility. Examples of self-contained, single-operating units or processing operations which may constitute a plant facility under this rule are a railroad switching yard, a railroad bypass route, and an ethanolamines unit.

The second rule of the plant facility provision added by your committee relates to the construction, reconstruction, or erection of a plant facility which was commenced before October 10, 1966. Under this rule, if pursuant to a plan of a taxpayer in existence on October 9, 1966, the taxpayer constructed, reconstructed, or erected a plant facility, and the construction, et cetera, was commenced before October 10, 1966, then all property of the type which is generally eligible for the investment credit which makes up the facility is not to be treated as suspension period property. For this purpose, construction, et cetera, of a plant facility is not to be considered to have commenced until it has commenced at the site of the plant facility. (This latter rule does not apply if the facility is not to be located on land and, therefore, where the initial work on the facility must begin elsewhere.) In this case, as in the case of the commencement of construction of a building, construction begins only when actual work at the site commences; for example, when work commences on the excavation for footings, et cetera, or pouring the pads for the facility, or the driving of foundation pilings into the ground. Preliminary work, such as clearing a site, test drilling to determine soil condition, excavation to change the contour of the land (as distinguished from excavation for footings), does not constitute the beginning of construction, reconstruction or erection.

The plant facility provision added by your committee contains a special rule applicable where a certificate of convenience and necessity has been issued to a taxpayer before October 10, 1966, by a Federal regulatory agency. The special rule applies where the certificate is applicable to two or more plant facilities which are included under a single plan of the taxpayer to construct, reconstruct, erect or acquire the plant facilities and more than 50 percent of the aggregate basis of all of the depreciable property making up the facilities is attributable either (i) to property the construction, reconstruction, erection of which was begun before October 10, 1966, or (ii) property the acquisition of which occurred before that date. In such a case, the plant facilities are to be treated as a single plant facility and will not be subject to the suspension of the investment credit or the suspension of accelerated depreciation.

5. Machinery and equipment rule (sec. 1 of the bill and sec. 48(h)(6) of the code)

The general rules as to what constitutes construction (reconstruction or erection) of machinery and equipment have been discussed above (see par. No. 1. above). Similarly, where binding contracts have been entered into before the beginning of the suspension period, the rules for machinery and equipment generally applicable have also been discussed above (see par. No. 2. above). In general, these rules provide that the construction begins when the production or assembly commences. In addition, the investment credit is also available with respect to machinery and equipment covered by a binding contract entered into before October 10, 1966. Under these rules, however, only the specific equipment and machinery commenced or ordered under a binding contract are eligible for the investment credit.

The bill as passed by the House contained two rules dealing with the completion of machinery and equipment. These rules, in general, provided for continuation of the investment credit if 50 percent of a machine or piece of equipment was on hand at the beginning of the suspension period or was acquired pursuant to a binding contract which was in effect at that time. However, under one rule the entire basis or cost of the property was taken into account and in the second, only the cost of the parts and components. Your committee's bill has rewritten these provisions of the House bill in order to have a single machinery and equipment rule.

Under the rule adopted by your committee, the investment credit will not be suspended with respect to any machinery or equipment more than 50 percent of the parts or components of which were on hand on October 9, 1966, or are acquired pursuant to a binding contract which was in effect on that date. The parts and components which are on hand or on order (under a binding contract) on October 9 must be held for, or have been ordered for, use in the machinery or equipment. This 50-percent requirement is to be determined on the basis of cost, and for the rule to apply, the cost of the parts and components must not be an insignificant portion of the total cost of the item of machinery or equipment.

Thus, for example, if there were a binding order on October 9, 1966, for the acquisition of the frame of an airplane, parts and components necessary for the airplane to become a functioning unit would also be eligible for the investment credit (even though not on order at that time) if these remaining parts and components did not account for 50 percent or more of the total cost of all the parts and components of the airplane. Accordingly, if the motors, galley, seats, navigation, and radio equipment and necessary spare parts acquired at the time the plane is put into operation had not been ordered before October 10, but constituted less than 50 percent of the total cost of the plane, the investment credit will be available not only with respect to the airframe but also with respect to this machinery and equipment as well.

This special rule (as was true of the two machinery and equipment completion rules of the House bill) is applicable to machinery and equipment wholly apart from any application the equipped building rule or the plant facility rule (explained above) may have because of the interrelationship of the machinery and equipment with a building and plant facility. However, a piece of machinery or equipment

which continues to receive the investment credit under this rule is to be included in determining whether the equipped building or plant facility of which it is a part meets the 50 percent requirement of the equipped building or plant facility provisions.

6. Certain leaseback transactions (secs. 1 and 2 of the bill and secs. 48(h)(7) and 167(i)(1) of the code)

Your committee understands that it is common practice for a business to enter into binding contracts for the purchase of machinery and equipment (and oftentimes, a building) used in its trade or business wherein the machinery and equipment (or the building) is sold to a third person but leased back by the person initially ordering the property. In such cases the person entering into the purchase contract initially is committed to purchase the article. For that reason the bill provides that where binding contracts have been entered into on or before October 9, 1966, and the property involved is transferred to a third party, the property is to be eligible for the investment credit or the accelerated depreciation (as the case may be), despite the suspension provided by this bill, if certain conditions are met.

This provision of your committee's bill differs from the House version in a number of respects. Under the House version, the transfer of the right to purchase and the leaseback has to be pursuant to a financing transaction. Under your committee's bill, whether the right to purchase and the leaseback are pursuant to a financing transaction is unimportant; all that is required is a transfer of a right to purchase property under a binding contract entered into before October 10 and a leaseback of the property to one of the parties to the contract. Your committee could see no reason why the transfer and leaseback provision should be limited to cases where financial institutions are involved. It found that in many cases leasing companies, and on occasion, even individual investors serve as the purchaser of the property to be leased to the operator. Therefore, it removed this financing limitation on the House provision.

Another respect in which your committee's bill differs from the House bill relates to the requirement in the House bill that the leaseback be for a long term. Under your committee's bill, the requirement of a long-term lease is imposed only in those cases where the lessor does not exercise his statutory election of allowing the lessee to claim the investment credit. Your committee decided not to require a long-term lease, where the election was made and the credit passed on to the lessee, because, in those cases, the recapture provisions come into play if the lessee's right to use the leased property terminates before the expiration of the period on which the investment credit originally is based.

The last change made by your committee in this provision as it passed the House is to cover the case where a person obligated under a presuspension period binding contract is only one of two or more joint lessees under the leaseback arrangement or where he subleases the property to or from another. Your committee believed that in these cases, too, the existence of a binding contract entered into before the suspension period justified excepting the leased property

from the denial of the investment credit. Accordingly, it amended the House bill to provide for these types of cases.

The types of arrangements which have been called to your committee's attention and which are covered by this provision are as follows:

(*a*) cases where the user of the machinery and equipment (or building) has a binding contract to purchase machinery and equipment (or a building) on October 9, 1966, and subsequently transfers the contract to purchase the property to a third party from whom the user leases back the right to use the property;

(*b*) cases where under a binding contract on October 9, 1966, to purchase machinery, equipment, or a building, a business obtains delivery of the property, immediately (before using it) transfers the property to a third party and leases the property back;

(*c*) cases where a builder or supplier of machinery, equipment, or buildings has entered into a lease arrangement with a business before October 10, 1966, subsequent to that time sells the property involved to a third person subject to the lease arrangement referred to.

The bill provides for cases of the type described above by providing that where a person who is a party to a binding contract transfers his right in the contract (or the property covered by contract) to another person, and a party to the contract retains a right to use the property under a lease, then to the extent of the transferred rights, this other person is to succeed to the position of the transferor with respect to the binding contract and the property. Thus, in the first two illustrations above, the investment credit is available because the third party (by succeeding to the position of the user and the business, respectively) is treated as having acquired property pursuant to a contract which was binding on him as of October 9 (see 2., above). In the third illustration, the credit is available because the third person (by succeeding to the position of the builder or supplier) is treated as having constructed the property pursuant to a binding contract to lease in effect on October 9. Under the exception for property constructed pursuant to certain leases (discussed in 7 below), property so constructed is eligible for the investment credit.

7. Certain leases involving third parties (secs. 1 and 2 of the bill and secs. 48(h) (8) and 167(i) (1) of the code)

Cases have been called to your committee's attention where binding contracts or leases have been entered into between parties prior to the beginning of the suspension period which require the construction or acquisition of machinery, equipment or buildings under the terms of the lease or contract arrangements. The bill provides for these situations even though they do not involve a binding contract of the kind described earlier in the bill between the person who will use the property and the person who will construct or supply it.

The types of cases called to your committee's attention involve situations, for example, where a builder of a shopping center may have entered into a lease agreement with a tenant for a major store building in a shopping center before October 10, 1966, and in connection with this lease agreement the builder agrees to build a specified num-

ber of shopping center units. In exchange for this agreement, the major store tenant agrees to equip and operate the store to be leased to him. In other cases, parties have agreed to construct and lease industrial plants to businesses and in exchange the businesses agree to equip the plants with machinery and equipment necessary for the businesses, either directly or under a sale and lease-back arrangement.

Still another example of types of cases covered by this provision involve urban renewal projects, where, under a binding contract with a municipality or other governmental agency, a builder is obligated to purchase land from the municipality and construct residential apartment buildings to be held for renting. Other cases may involve State political subdivisions which require the construction of specified productive facilities in exchange for the subdivision's expenditure of (or contract to spend) substantial amounts which benefit the other party to the contract.

Provision is also made here for binding contracts entered into before the suspension period requiring the construction of specified property to be used in the production of products to be sold under the contract. In these cases, provision is made only where the purchasers are required to take substantially all the products to be produced from the property for a substantial portion of its estimated useful life. An example would be where a party is obligated under the terms of the contract to build an oxygen plant specified in the contract for the purpose of supplying oxygen for use in a steel company's oxygen furnace.

To cover cases of the type described above, the bill provides that where a binding lease or contract is in effect on October 9, 1966, under which a lessor or lessee (or both) is obligated to construct (reconstruct or erect) or acquire machinery, equipment, or a building which is specified in a lease or contract, then any property constructed under such a lease or contract is not to be denied the investment credit or accelerated depreciation, as the case may be. Similarly, in the case of binding contracts requiring the construction of specified productive property, the bill provides that where the contract is with a political subdivision which is required to make substantal expenditures which benefit the taxpayer, or is with a party required to take substantially all the products to be produced over a substantial portion of the expected useful life of the property, the property is not to be treated as suspension period property.

The first provision in the case of lessees applies only to those who had leases on October 9, 1966. However, in cases where a project includes property, in addition to that covered by a specific lease agreement, the rule is to apply to this other property only if the binding leases and contracts in effect on October 9, 1966, cover real property representing at least a quarter of the entire project. (This is to be determined on the basis of the rental value of the different parts of the project.) This limitation is designed to prevent a large project from being covered merely because of minor or incidental lease agreements in effect on October 9, 1966. As indicated previously this provision applies to sales contracts as well as lease contracts. In both cases, however, the property to be covered must be specified at the time of the lease on sale contract.

While the bill provides that the machinery, equipment, or building to be provided be specified in the lease or contract, this is not intended to preclude this equipment being specified in a separate document of which both parties were fully aware at the time of the lease agreement. Nor is it required that all of the equipment and machinery be specified in detail at that time so long as the general types and amount of such equipment is fairly determinable at the time the lease or contract is entered into.

8. Rules where property is transferred at death, etc. (secs. 1 and 2 of the bill and secs. 48(h)(9) and 167(i)(1) of the code)

The bill provides that in determining whether property is to be treated as if acquired or under binding contract before the beginning of the suspension period (and therefore is eligible for the investment credit or accelerated depreciation), certain transfers are to be disregarded. These are cases where it seems appropriate for the transferee "to step into the shoes" of the transferor.

The first transfer where the transferee is treated the same as the transferor is a transfer by reason of death. Under this provision, property (or a contract to purchase property) with respect to which the investment credit would not be suspended in the hands of the decedent continues to be eligible for the investment credit in the hands of the person who acquires the property from the decedent. Similarly, if a person inherits a building under construction from a decedent who started construction before October 10, 1966 (or prior to that date had a binding contract for the construction of the building), accelerated depreciation will be available to the transferee when he places the building in service.

This same treatment is also applied to certain specified transfers in which the basis of the property in the hands of the transferee is determined by the reference to its basis in the hands of the transferor. The specified transfers are—

(*a*) transfers to a corporation upon the liquidation of a subsidiary (sec. 332 of the code),

(*b*) transfers to a controlled corporation (sec. 351 of the code),

(*c*) transfers pursuant to corporate reorganizations (secs. 361, 371(a), and 374(a) of the code),

(*d*) transfers of property to a partnership by a partner in exchange for an interest in the partnership (sec. 721 of the code), and

(*e*) transfers by a partnership to a partner (sec. 731 of the code).

In addition, where under a special provision of the Code (sec. 334(b)(2)), the acquisition by a corporation of the stock of another corporation and the liquidation of the acquired corporation is treated as the purchase of the assets of the liquidated corporation for purposes of computing the basis of the assets acquired, the transfer of the assets is to be disregarded in determining whether the suspensions are to be inapplicable if the stock of the distributing corporation was either acquired before October 10, 1966, or pursuant to a binding contract to acquire the stock which was in effect on October 9, 1966, or both.

9. Property acquired from affiliate corporations (secs. 1 and 2 of the bill and secs. 48(h) (10) and 167(i) (1) of the code)

Your committee has added to the bill a provision to cover a problem which was called to its attention by corporations which are members of affiliated groups. It is a common practice in some affiliated groups to do their purchasing outside the group through one of the corporations which is a member of the group. In these situations your committee believes that acquisitions by, and binding contracts of, the purchasing member of the group should be considered as acquisitions by, or contracts of, the corporation for which they are made, for purposes of the bill. For this reason, your committee's bill provides that property acquired by a corporation which is a member of an affiliated group for another member of the same group is to be treated as having been acquired by the other member on the date it was acquired by the purchasing corporation; and that where a binding contract for the construction, reconstruction, erection, or acquisition of property has been entered into by the one member of a group, the corporation on whose behalf the contract was made is to be treated as having entered into the contract on the date on which it was entered into by the other member. In addition, the corporation is to be treated as having commenced construction, etc., of any property on the date on which another member commenced construction, etc.

D. Certain limitations on the investment credit (sec. 3 of the bill and sec. 46 of the code)

1. Present law

As noted previously, the amount of the investment credit which may be claimed in any one year is currently limited to the full amount of the tax liabiilty up to $25,000 plus 25 percent of any tax liability in excess of $25,000. The amount of any unused credit resulting from the application of this limitation can be carried back to the 3 prior taxable years and then, to the extent not used, carried forward to the succeeding 5 taxable years.

2. Increase in percentage limitation on the investment credit

The bill increases the limit on the amount of investment credit which, beginning after Dec. 31, 1967, may be claimed in any year to the first $25,000 of the tax liability plus 50 percent of any tax liability in excess of $25,000.

The existing limitation on the use of the investment credit was designed to prevent the credit, in combination with other tax benefits, from relieving the taxpayer from any substantial tax contribution. Experience indicates, however, that the current limit is unduly restrictive in many cases. Presently, companies with low net incomes relative to their investments in eligible property are more severely limited than companies with large net incomes relative to their investment in eligible property. Many firms in the former category are faced with the loss of part of the credit that they earned as a result of their investment in eligible property because they are so severely restricted by the current rules. Raising the limit to 50 percent rather than 25 percent of the tax liability in excess of $25,000 will, in the opinion of your committee, relieve undue hardships imposed on some firms without impairing the purpose of the provision.

Increasing this percentage serves the purpose of the bill since it increases the incentive given to investors to defer acquisitions of property until the suspension period is terminated. Moreover, the restrictiveness of the present provisions is unfair to those whose investments are large relative to their incomes. This change also will have the effect of lessening the tendency to enter into leasing agreements in order to avoid the impact of the present restrictive provision.

The increase in the limitation on the amount of the investment credit which may be claimed from 25 percent to 50 percent of tax liability in excess of $25,000 is to be effective with respect to taxable years which end after the last day of the suspension period.

In the case of taxable years which begin before the end of the suspension period and end after that time, the bill provides that the percentage limitation is to be pro rated by giving 25 percent the weight of the number of days before the end of the suspension period and 50 percent the weight of the number of days after the end of the suspension period.

3. Provision of a 7-year carryforward

The bill also extends the present 5-year period in which unused credits may be carried forward to 7 years. This extended carryover period will apply with respect to investment credits which remain unused after the application of such carryovers, where applicable, to taxable years ending in 1967.

This change—like raising the limitation to 50 percent—will help taxpayers unable to use their full investment credits in the years in which they arise. Therefore, this change will be beneficial to taxpayers with investments which have in the past been, and will in the future after the suspension period be, large relative to their incomes. Thus, this will compensate in part for the restrictive impact of the 25-percent limitation in past years. This seems appropriate since these credits in the past years were accumulated as a result of investments made at a time when an increase in business plant and equipment spending was urgently needed.

E. Treasury savings bonds not subject to the interest rate ceiling (sec. 5 of the bill and sec. 22(A) of the Second Liberty Bond Act)

1. Reasons for the amendment

At the present time, the Treasury is prevented by law from issuing long-term securities at a rate of interest which, on the basis of the face amount of the security, exceeds 4¼ percent. This interest rate ceiling does not, however, prevent the Treasury Department from offering short-term securities at effective rates of interest in excess of 4¼ percent. Indeed, when prevailing market rates of interest significantly exceed 4¼ percent, the Treasury Department has difficulty in obtaining funds in a competitive market. The effect of this has been to force the Treasury to an increasing extent to rely on short-term securities to fund its debt.

2. Explanation of provision

Your committee approved an amendment which permits the Secretary of the Treasury, at his discretion, to issue a new type of retirement and savings bond which may carry a rate of interest, based on the issue price or the bond, which may exceed the present interest rate

ceiling. The bonds are to carry an interest rate up to 5 percent a year compounded semiannually or, with the approval of the President, may carry an even higher interest rate. These retirement and savings bonds are to mature in not less than 10 nor more than 30 years from the date on which they are issued.

The issuance of these retirement and savings bonds will provide the general public with a bond whose interest rate is stated in explicit terms. Furthermore, the issuance of these bonds will tend to lengthen the average maturity of the Federal debt. As of August 31, the average maturity of the Federal debt was only 4 years 11 months. A further reduction in the average maturity of the debt would be undesirable.

The bonds are to be issued on a discount basis. The Secretary of the Treasury, with the approval of the President, is authorized to decide when to issue these bonds, in what forms and what amounts to issue them, whether to issue them through the postal service or otherwise, what maturity between 10 and 30 years to provide for them, what interest rate to establish for them, and what terms and conditions to provide for redemption prior to maturity. The committee understands that, to the extent possible, the Treasury will issue these securities for, terms of 10, 15, 20, 25, or 30 years. He is also authorized to fix the maximum amount of such bonds issued in any one year that any one person may hold at any one time. He may not fix this amount, however, at less than $3,000. The Secretary is also authorized to provide that owners of retirement and savings bonds may, if they wish, retain the bonds after the date of maturity and continue to earn interest upon them at rates consistent with yields on new issues of similar securities.

For tax purposes, the difference between the price paid for such a bond and the value when redeemed, whether at, before, or after maturity, is to be treated as interest income.

The bonds are not to bear the circulation privilege.

These provisions are to be effective following the date of enactment of this bill.

IV. TECHNICAL EXPLANATION

SECTION 1. SUSPENSION OF THE INVESTMENT CREDIT

Section 1 of the bill, as passed by the House, has been approved by your committee with the amendments discussed below. For the technical explanation of this section of the bill (other than the amendments made by your committee), see page 29 of the report of the Committee on Ways and Means on the bill (H. Rept. 2087, 89th Cong., 2d sess.). In addition to the amendments discussed below, your committee has amended certain provisions of section 1 of the bill by changing the dates September 8, 1966, and September 9, 1966, to October 9, 1966, and October 10, 1966, respectively, in order to conform these dates to the change which your committee has made in the date on which the suspension period commences.

Equipped building rule

Under the bill as passed by the House, paragraph (4) of section 48(h) provided, in general, a rule for the determination of whether a building and the machinery and equipment necessary for the

planned use of the building are to be treated as section 38 property which is not suspension period property. Your committee has amended this paragraph to make it clear that, for purposes of the equipped building rule, a special purpose structure shall be treated as a building. Special purpose structures which are treated as buildings for these purposes include, for example, grain storage bins, blast furnaces, coke ovens, and brick kilns. In addition, your committee has made a clerical amendment.

Plant facility rule

Section 48(h) of the code, as passed by the House, has been amended by your committee by adding a new paragraph (5) in order to except from the definition of suspension period property certain facilities not housed in buildings.

Subparagraph (A) of the new paragraph (5) provides that all section 38 property comprising a plant facility shall be treated as section 38 property which is not suspension period property if: (i) the taxpayer has constructed, reconstructed, erected, or acquired a plant facility pursuant to a plan of the taxpayer which was in existence on October 9, 1966, and which was not substantially modified at any time after such date and before the taxpayer placed the plant facility in service; and either (ii) construction, reconstruction, or erection of such plant facility was commenced before October 10, 1966, or (iii) more than 50 percent of the aggregate adjusted basis of all the property of a character subject to the allowance for depreciation making up such plant facility is attributable to property the construction, reconstruction, or erection of which was begun by the taxpayer before October 10, 1966, or the acquisition of which by the taxpayer occurred before such date. In applying this "more than 50 percent test," the rules of paragraphs (3) (relating to binding contracts) and (6) (relating to machinery or equipment) shall be applied.

Subparagraph (B) of the new paragraph (5) defines the term "plant facility." Under this definition, a plant facility is a facility not housed in a building, and not including any building or buildings unless such building or buildings constitute an insignificant portion of the facility. To qualify as a plant facility, a facility must also be: (1) a self-contained, single operating unit or processing operation; (2) located on a single site; and (3) identified, on October 9, 1966, in the purchasing and internal financial plans of the taxpayer as a single unitary project. Thus, for example, a chemical manufacturing complex would not constitute a plant facility, but a portion of the complex, consisting of physically connected, closely adjacent items of equipment which form a single functioning unit and produce a single product (whether or not commercially marketable without further processing) would qualify as a plant facility. The term "operating unit" for these purposes is used in a much more restricted sense than in section 614 of the code.

Subparagraph (C) of new paragraph (5) provides a special rule with respect to two or more related plant facilities which are built or acquired pursuant to a certificate of convenience and necessity issued by a Federal regulatory agency. Under the provisions of subparagraph (C), two or more plant facilities which are included under a single plan of the taxpayer to construct, reconstruct, erect or acquire

such plant facilities, are treated as a single plant facility if the following conditions are met:

(1) A Federal regulatory agency has issued a certificate of convenience and necessity before October 10, 1966, with respect to such plant facilities; and

(2) More than 50 percent of the aggregate adjusted basis of all the property of a character subject to the allowance for depreciation making up such plant facilities is attributable to either property the construction, reconstruction, or erection of which was begun by the taxpayer before October 10, 1966, or property the acquisition of which by the taxpayer occurred before such date.

Subparagraph (D) of new paragraph (5) specifies that, generally, construction of a plant facility commences only when physical construction, reconstruction, or erection work begins at the intended site of the facility. The manufacture or assembly of components of the facility away from the site does not constitute the commencement of construction. If on-site construction has not commenced, the more than 50-percent test of paragraph (5) (A) (iii) would be applied to determine whether the entire plant facility was not suspension period property. On-site construction commences, for example, with the erection of components or excavation for the foundation.

Where the plant facility is not to be located on land (for example on an offshore drilling platform), this rule does not apply. Therefore, construction would commence when the fabrication or assembly of such facility begins.

Machinery or equipment rule

Your committee has amended the provisions of paragraph (5) of section 48 (h) of the bill, as passed by the House, and has redesignated it as paragraph (6). Under new paragraph (6), a piece of machinery or equipment is to be treated as property which is not suspension period property if—

(A) more than 50 percent of its parts and components (determined on the basis of cost) were held by the taxpayer on October 9, 1966, or are acquired pursuant to a contract binding on the taxpayer on that date, for inclusion or use in such piece of machinery or equipment, and

(B) the cost of all of the parts and components of the item is not an insignificant proportion of the total cost of the item.

To qualify for inclusion in the numerator of the fraction described in the preceding sentence, parts and components must be held or acquired by the taxpayer for inclusion or use in a piece of machinery or equipment to be constructed or assembled by him. Thus, items acquired for sale to customers, or items acquired as replacement parts for existing machinery, do not qualify for inclusion in the numerator of this fraction. If by reason of the provisions of paragraph (6) a piece of machinery or equipment is not considered suspension period property, then the entire adjusted basis of the completed item is taken into account in determining qualified investment. For purposes of this rule, parts and components of a piece of machinery or equipment placed in service prior to the beginning of the suspension period are not considered in determining whether 50 percent of the parts and components were held by the taxpayer on October 9, 1966.

Certain lease-back transactions

Your committee has amended the provisions of paragraph (6) of new section 48(h) of the bill, as passed by the House, and has redesignated the paragraph as paragraph (7). Generally, the paragraph passed by the House provided that, where a party to a binding contract for the construction or acquisition of property transfers the contract to another person but retains the right to use the property under a lease, the property is not treated as suspension period property. One of the requirements of the paragraph, as passed by the House, was that the transfer be pursuant to a "financing transaction." Your committee has deleted this phrase to remove any implication that the transfer must be to a financial institution.

Under the paragraph passed by the House, the lease of the property had to be for a long-term. Your committee removed this requirement in those cases in which the lessee receives the investment credit by reason of an election by the lessor under section 48(d). However, in those cases where the lessor retains the investment credit, the long-term lease requirement remains unchanged. In determining whether a lease meets this requirement, periods for which the lease may be renewed at the option of the lessee shall be taken into account if the initial term of the lease is for a substantial period.

Your committee understands that in certain industries contracts to lease equipment frequently contain options for the purchase of the equipment. Where such an agreement otherwise meets the requirements of paragraph (3), property purchased under such an option will be considered to have been acquired pursuant to a binding contract.

Your committee also amended the provision as passed by the House to make it clear that an original party to the contract need not retain the exclusive right to use the property. Thus, for example, the provision may apply to cases in which the transferee leases the property back to the transferor for a part of each year and to a third party for the remaining portion of the year.

Certain lease and contract obligations

Your committee has amended paragraph (7) of section 48(h) as passed by the House, and redesignated it as paragraph (8) of such section. Your committee has added two sentences to the end of this paragraph to provide that property required to be constructed under the terms of certain types of contracts shall not be treated as suspension period property.

This exception applies where the following requirements are met:

(1) the taxpayer is required to construct, reconstruct, erect, or acquire property which is specified in a contract and is to be used to produce one or more products;

(2) the other party to the contract is required to purchase substantially all of the products to be produced over a substantial portion of the expected useful life of the property; and

(3) the contract is binding on the taxpayer on October 9, 1966.

Where a political subdivision of a State is a party to the contract and is required by the terms of the contract to make substantial expenditures which benefit the taxpayer, the second requirement is inapplicable. Unless the requirements of this paragraph are met, the

fact that a taxpayer constructs, reconstructs, erects, or acquires property in order to furnish goods or services required of him under a binding contract will not be sufficient to remove the property from the definition of suspension period property.

Property acquired from affiliated corporation

Your committee has added a new paragraph (10) to section 48(h). The new paragraph provides special rules applicable to corporations which are members of an affiliated group.

Under the provisions of this paragraph, if property is transferred by one member of an affiliated group of corporations to another member of the same group, then—

(A) the transferee is treated as having acquired the property in the date on which it was acquired by the transferor;

(B) the transferee is treated as having entered into a binding contract for the construction, etc. of the property on the date on which the transferor entered into the contract; and

(C) the transferee is treated as having commenced the construction, etc. of such property on the date on which the transferor commenced such construction, etc.

For purposes of paragraph (10), the term "affiliated group" has the meaning assigned to it by section 1504(a) of the code, except that the exclusionary provisions of section 1504(b) of the code are inapplicable. The rule of this paragraph applies whether or not the affiliated group elects to file a consolidated return.

Paragraph (10) does not specify that, for purposes of determining whether or not property has been ordered during the suspension period, an order placed by any member of an affiliated group shall be considered to have been placed by the member who claims the investment credit for the property. Such a rule is unnecessary because the definition of "suspension period property" includes property acquired pursuant to an order placed during the suspension period, whether or not the order was placed by the taxpayer. Hence, if one member of an affiliated group orders property during the suspension period and transfers the order to another member of the group, the property will be deemed to be suspension period property in the hands of the acquiring corporation even though that corporation purchases it after the suspension period, since the purchase was pursuant to an order placed during the suspension period. Similarly, if one member of an affiliated group places an order during the suspension period, subsequently acquires the property, and transfers it to another member of the group after the suspension period but before placing it in service, the property is suspension period property in the hands of the transferee.

Railroad rolling stock

Your committee has added a new paragraph (13) to section 48(h), as passed by the House. This new paragraph provides that any property which is railroad rolling stock designed to carry freight or passengers (other than self-propelled cars) shall be treated as property which is not suspension period property. Therefore, this paragraph is inapplicable to floating equipment, locomotives, or self-propelled passenger cars. Furthermore, this paragraph does not apply to con-

tainers or vehicles carried on railroad cars, such as piggyback trailers.

Paragraph (13) applies only to rolling stock operated by a railroad which is in the trade or business of transporting passengers or freight for hire. However, where rolling stock is operated by such a railroad, the paragraph applies even though the rolling stock is owned by a taxpayer who does not conduct a railroad business.

Property to equip new UHF television stations

Your committee has added a new paragraph (14) to section 48(h), as passed by the House. The new paragraph provides that in the case of a taxpayer who before October 10, 1966, had been granted an authorization for an ultrahigh frequency television broadcasting station by the Federal Communications Commission, section 38 property constructed, reconstructed, erected, or acquired by the taxpayer which is necessary for the operation of the station shall be treated as property which is not suspension period property provided that three conditions are met. These conditions are: (1) the taxpayer, prior to October 10, 1966, had a binding contract for the acquisition of the transmitter necessary for the operation of the station; (2) the taxpayer had not commenced the operation of the station before October 10, 1966; and (3) the section 38 property is constructed, reconstructed, erected, or acquired in accordance with the authorization granted by the Federal Communications Commission (as modified by any subsequent order of the Commission).

Clerical amendments

Paragraphs (7), (8), (9), and (10) of section 48(h), as passed by the House, have been redesignated by your committee as paragraphs (8), (9), (11), and (12), respectively, to conform to other changes made by your committee.

Exemption from suspension of $25,000 of investment

Section 48(i), as passed by the House, provided a general $15,000 exemption from suspension of the investment credit. Your committee has amended section 48(i) by changing the $15,000 limitation to $25,000 and by making certain clerical changes.

Suspension period

Section 48(j), as passed by the House, provided that the term "suspension period" means the period beginning on September 9, 1966, and ending on December 31, 1967. Your committee has amended section 48(j) to provide that the suspension period shall commence on October 10, 1966, rather than September 9, 1966.

SECTION 2. SUSPENSION OF ACCELERATED DEPRECIATION ON REAL PROPERTY

Your committee has approved this section with the amendments discussed below. For a technical explanation of this section of the bill (other than the amendments made by your committtee), see pages 38 and 39 of the report of the Committee on Ways and Means on the bill. Your committee has amended paragraph (2) of new section 167(i), as passed by the House, and has redesignated it as paragraph (3). In addition, your committee has added a new paragraph (2) to section 167(i).

Paragraph (1) of section 167(i), as passed by the House, provides, in general, that the accelerated methods of depreciation listed in section 167(b) (2), (3), and (4) may not be used with respect to real property (other than real property which is section 38 property if (1) the construction, reconstruction or erection of the property by any person begins during the suspension period, or (2) an order for such construction, reconstruction, or erection is placed by any person during the suspension period.

New paragraph (2), as added by your committee, provides a limited exception to the paragraph (1) prohibition on the use of the accelerated methods of depreciation. This exception applies to any item of real property selected by the taxpayer if the cost of such item, when added to the aggregate cost of all other items of real property selected by the taxpayer for the entire suspension period, does not exceed $100,000. Thus, no item of real property may be selected if (1) its cost exceeds $100,000, or (2) its cost, when added to the aggregate cost of all other items selected, exceeds $100,000.

New paragraph (2) further provides that under regulations prescribed by the Secretary of the Treasury or his delegate rules similar to the rules provided in section 48(c) (2) shall be applied for purposes of the new paragraph (2). Thus, for example—

(1) The selection of items of real property by the taxpayer shall be made at such time and in such manner as the Secretary of the Treasury or his delegate prescribes by regulations. Likewise, such a selection, once made, may only be changed in the manner and to the extent provided for by the regulations of the Secretary of the Treasury or his delegate.

(2) In the case of an affiliated group, as defined in section 48(c) (3) (C), the $100,000 limitation shall be apportioned among the members of the group

(3) In the case of a partnership, the $100,000 limitation shall apply at the partnership level and again at the partner level.

(4) In the case of married individuals, rules similar to the rules of section 48(c) (2) (B) shall apply.

The application of new paragraph (2) of section 167(i) may be illustrated by the following examples:

Example (1).—On December 1, 1966, A contracts with a builder for the construction of a building to be used in A's business. The building is completed on January 1, 1968, and immediately placed in service by A. The cost of the building is $150,000. The exception in new paragraph (2) does not apply to the building since its cost exceeds $100,000. Thus, the accelerated methods of depreciation listed in section 168(b) (2), (3), and (4) may not be used with respect to any portion of the $150,000 cost of the building.

Example (2).—On November 1, 1966, A begins the construction of three buildings to be used in his business. Building No. 1, with a cost of $30,000 is completed on March 1, 1967, and is immediately placed in service by A. Building No. 2, with a cost of $40,000, is completed and placed in service on February 1, 1968. Building No. 3, with a cost of $50,000, is completed and placed in service an January 1, 1969. Under the exception in new paragraph (2), A selects Building No. 2 and Building No. 3. Thus, the accelerated methods of depreciation listed in section 167(b) (2), (3), and (4) may be used

with respect to such buildings. However, the accelerated methods of depreciation may not be used with respect to any portion of the $30,000 cost of Building No. 1.

Your committee has amended the definition of the term "suspension period," contained in redesignated paragraph (3), to mean the period beginning October 10, 1966, and ending December 31, 1967.

SECTION 3. DETERMINATION OF INVESTMENT CREDIT ALLOWED

This section has been approved by your committee without change. For the technical explanation of this section of the bill, see page 39 of the report of the Committee on Ways and Means on the bill.

SECTION 4. EFFECTIVE DATE

Except for changing the date September 8, 1966, to October 9, 1966, this section has been approved by your committee without change. For the technical explanation of this section of the bill, see page 41 of the report of the Committee on Ways and Means on the bill.

V. CHANGES IN EXISTING LAW

In the opinion of the committee, it is necessary in order to expedite the business of the Senate, to dispense with the requirements of subsection 4 of rule XXIX of the Standing Rules of the Senate (relating to the showing of changes in existing law made by the bill, as reported).

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