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INCOME TAX TREATMENT OF CERTAIN DISTRIBUTIONS PURSUANT TO BANK HOLDING COMPANY ACT OF 1956

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

REPORT

[To accompany H.R. 4765]

The Committee on Finance, to which was referred the bill (H.R. 4765) relating to the income tax treatment of certain distributions pursuant to the Bank Holding Company Act of 1956, as amended, having considered the same, reports favorably thereon with amendments and recommends that the bill as amended do pass.

I. SUMMARY

Your committee has accepted the House provision without change (except for adding an effective date) but has added four amendments relating to different tax matters. The Treasury Department has indicated that it does not object to any of these committee amendments. As a matter of fact, it recommends the amendment regarding mortgage guaranty insurance.

Bank holding company distributions.—The provision in the House-passed bill which your committee has accepted without change is concerned with corporations which became bank holding companies as a result of the 1966 amendments to the Bank Holding Company Act of 1956. The 1966 amendments removed an exemption provided by prior law and, as a result, one company will become a bank holding company without any action on its part. As a result of being classified as a bank holding company, this corporation will have to dispose of either the banking or the nonbanking interests. This bill provides in this case that the corporation may make a distribution of either one of these two categories of interests without the shareholders having to pay tax upon the stock or other property received so long as all distributions in kind are made on a pro rata basis to all shareholders. The Treasury Department has indicated that it has no objection to this

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provision. Your committee added an amendment to provide that this provision applies to taxable years ending after the date of enactment of the 1966 amendatory act.

Mortgage guaranty insurance.—Your committee has added an amendment (sec. 2 of the bill) to the bill to solve a problem faced by companies which provide mortgage guaranty insurance. They are subject to State regulation and are almost uniformly required to place half of their earned premiums, in contingency reserves for 15 years to provide protection to policyholders from losses which might result from adverse economic conditions. The committee amends the law to provide a special deduction for additions to an extraordinary loss reserve for amounts which State law or regulations require a mortgage guaranty insurance company to add to such a reserve, but not in excess of 50 percent of earned premiums. However, the special deduction is to be allowable only if the tax benefit obtained from the deduction of additions to the reserve is invested in a special issue of noninterest bearing Government bonds. The bonds may be used for payment of income taxes which will be due when the reserve is returned to income (no later than 10 years after the deduction) or may be redeemed in the event of extraordinary losses during the period of the reserve.

Unfunded pension plans of educational and other tax-exempt organizations.—Another amendment added by your committee (sec. 3 of the bill) provides that the $5,000 death benefit exclusion from the income tax, and the estate and gift tax exclusions are to be available for employees of universities and certain other tax-exempt organizations covered by unfunded retirement programs, in cases where these employees are granted the option of participating in a funded retirement program and it is determined that the lack of funding is not likely to jeopardize the payment of the benefits. This amendment also provides that the 20-percent limitation applicable in determining the maximum exclusion in the case of nonqualified annuity contracts in the case of professors and other employees of certain tax-exempt organizations is to include not only contributions with respect to all annuity contracts but also contributions with respect to all other pensions as well (including unfunded plans).

Investment credit carrybacks resulting from net operating loss carrybacks.—Your committee (sec. 4 of the bill) modifies the investment credit carryback provision of present law to permit such a carryback where it results from a net operating loss carryback. Presently, the investmant credit carryback is not available where it results from the reduction of the allowable credit in a year as a result of a net operating loss carryback to that year.

Spin-off of life insurance company.—The last amendment added by your committee (sec. 5 of the bill) permits a subsidiary company which is a life insurance company to distribute the stock of another corporation, which also is a life insurance company, to its parent holding company without the payment of any so-called phase III tax.

II. BANK HOLDING COMPANY DISTRIBUTIONS

Reasons for the provision.—In 1956, Congress passed legislation placing certain corporations referred to as bank holding companies under the control of the Federal Reserve Board. In general, these were organizations controlling two or more banks. Under the legisla-

tion, a bank holding company was prohibited from engaging in any business other than banking. As a result, organizations which in 1956 controlled two or more banks and at the same time owned interests in other businesses generally were required to dispose of either their banking or their nonbanking interests. Corporations classified as bank holding companies under the Bank Holding Company Act of 1956 usually disposed of either their banking or their nonbanking interests by distributing one or the other of these classes of interests to their shareholders. Since Congress was requiring these corporations to distribute one of these classes of interests, in 1956 it provided generally that these stock distributions, to the extent they involve property acquired before May 15, 1955, could be made without tax consequences to the shareholders receiving the distributed stock. In the absence of the special tax provisions enacted in 1956, most stock distributions would have been treated as ordinary income (dividends) to the shareholders receiving them.

The 1956 act contained certain exceptions to the requirement that dispositions of either banking or nonbanking interests had to be made in the case of companies holding interests in two or more banks. One of these exceptions provided that a company was not to be considered a bank holding company if it was registered prior to May 15, 1955, under the Investment Company Act of 1940 (or was an affiliate of such a company) unless the company or its affiliate *directly* owned 25 percent or more of the voting shares of each of two or more banks. This exception permitted companies of this type to own indirectly a 25 percent, or larger, interest in two or more banks.

In 1966 (Public Law 89-485; H.R. 7371) Congress repealed this exception with the result that any company falling within this category now must divest itself of either its banking or nonbanking interests where its indirect ownership equals or exceeds 25 percent. It was stated that this exemption initially was granted because it was felt that regulation under the Investment Company Act of 1940 would provide adequate protection. However, it was indicated that experience has demonstrated that SEC's authority under the Investment Company Act is not a substitute for the type of control provided under the Bank Holding Company Act from the standpoint of banking policies. It was further stated that the exemption now applies only to the Financial General Corp., an affiliate of the Equity Corp., which is a registered investment company.[1]

The Financial General Corp., through subsidiary corporations, owns 25 percent or more of the stock of 21 banks in five States and the District of Columbia. In addition, it controls a number of nonbanking businesses, including insurance, financing, and manufacturing companies. Many of these interests were acquired after May 15, 1955 (the date before which the property must have been acquired for the 1956 tax relief to apply).

Since the Congress in 1956 provided that where it required disposition of either the previously held banking or nonbanking interests, there should not be tax consequences to the shareholders upon any distributions occurring as a result of this action, it seems appropriate to extend the same general treatment under the 1966 amendments. Therefore, the House-passed provision approved by

[1] However, it was indicated that there are roughly 300 companies that registered under the 1940 act before May 15, 1955, which apparently could in the future take advantage of this provision had this exemption not been removed.

the committee provides that any corporations required to divest their banking or nonbanking interests as a result of the passage of the Bank Holding Company Act Amendments of 1966 also are to have tax-free treatment available. This also is consistent with the treatment provided under present law where divestitures are required to effectuate the policies of the Securities and Exchange Commission.

For these reasons, this bill extends the tax-free treatment originally provided with respect to distributions required as the result of the Bank Holding Company Act of 1956, to distributions of property acquired on or before April 12, 1965, which must be made as a result of the 1966 amendments to that act. However, to be sure that there is no opportunity for tax manipulation, this treatment is made available only if all of the distributions made in kind—i.e., other than in money—are made on a pro rata basis to all shareholders.

Explanation of provision.—Under present law, as a result of the 1956 act, a corporation which is classified as a bank holding company is given its choice of two alternative courses of action: It may remain a bank holding company, in which event it must distribute its nonbanking interests; or it may retain its nonbanking interests and dispose of its banking interests to the extent required so it is no longer classified as a bank holding company.

Under the 1956 legislation, a corporation was classified as a "bank holding company" and, therefore, subject to the provisions of the bill if (1) the company directly or indirectly controlled 25 percent or more of the voting shares of two or more banks (or of bank holding companies); (2) the company controlled the election of a majority of the directors of two or more banks; or (3) trustees for the shareholders of the company held 25 percent or more of the stock of two or more banks (or of bank holding companies).

A number of exceptions to the classification specified above are included in the 1956 act. Among these is one which provides an exclusion for any company which is registered under the Investment Company Act of 1940 and was so registered prior to May 15, 1955 (or is affiliated with a company meeting these tests), unless the company (or the affiliate) directly owns 25 percent or more of two or more banks.

Thus, a company registered under the Investment Company Act (which was so registered before May 15, 1955) could indirectly own over 25 percent of the voting stock of two or more banks—e.g., this ownership could be divided among related corporations—without being classified as a bank holding company and without being required to dispose of either its banking or nonbanking interests (and without subjecting itself to Federal Reserve Board control). This exemption from the bank holding company provisions was removed by the 1966 amendments.

This bill provides in general that no tax is to be imposed on the shareholders where companies, because of the removal of this exemption in 1966, are required to make distributions of either their banking or nonbanking interests acquired on or before April 12, 1965. Present law, as amended by this bill, obtains the results referred to above, by permitting a corporation which becomes classified as a bank holding company, its choice of two alternative tax-free routes for disposing of its banking or nonbanking interests.

First, if a corporation decides to remain a bank holding company, it may distribute its nonbanking interests, referred to as prohibited

property, to its shareholders without the recognition of any gain by the shareholders on the distribution. The distribution is tax free to the shareholders only if the Federal Reserve Board certifies the corporation has disposed of all property necessary to effectuate the policies of the Bank Holding Company Act. For this purpose, "prohibited property" in general means stocks, securities, and other obligations or assets of nonbanking businesses, to the extent the bank holding company is required to divest itself of these assets under the Bank Holding Company Act. The term does not include cash, Government bonds, or certain short-term obligations. Generally, these do not come within the definition of assets which must be distributed by a bank holding company.

In the case of the distributing corporation, the usual provisions of the tax laws apply. Under these provisions, gain generally is not recognized to the distributing corporation except under unusual circumstances such as in the case of the distribution of LIFO inventory, the distribution of property subject to a liability in excess of its adjusted basis, or the distribution of certain installment obligations.

The distribution of "prohibited property" may be made either directly to the shareholders of the bank holding company or may be transferred to a wholly owned subsidiary created to receive the "prohibited property." In this latter event, the stock of the subsidiary must then be immediately distributed to the shareholders of the bank holding company for the distribution to be free of tax.

Second, if a corporation chooses not to be a bank holding company, it may distribute to its shareholders any bank stock or other property of the kind which causes it to be a bank holding company without the recognition of gain to the shareholders. In this case, for the distribution to be tax free to the shareholders, the Federal Reserve Board must certify within a specified period of time that the company has distributed sufficient property so that it no longer is a bank holding company. In this case the corporation may distribute to its shareholders all of its shares of bank stock without the recognition of gain even though it would be possible to retain shares of stock in one bank without being classified as a bank holding company.

The Bank Holding Company Act of 1956 restricted the nonrecognition treatment described above to property which was owned by a company on May 15, 1955. This restriction was considered necessary to prevent corporations from purchasing interests in banks or other businesses in order that their shareholders might benefit from the tax-free distribution treatment provided in these cases. While the May 15, 1955, date was, of course, appropriate for corporations which became bank holding companies in 1956, a later date is needed for a corporation which became a bank holding company because of the 1966 amendments. Therefore, this date is advanced to April 12, 1965, in the case of any company which became a bank holding company as a result of the enactment of the Bank Holding Company Amendments of 1966.

This is the date of introduction in the House of the bill which ultimately led to the enactment of the 1966 Bank Holding Company Amendments. Thus, the tax-free treatment is made available with respect to a company required to dispose of either its banking or its nonbanking interests as a result of the 1966 amendments, only with respect to property it held on the date it was indicated that this exemption might be removed.

Apart from the change in dates referred to above, the tax-free treatment in the case of distributions to shareholders in the case of corporations coming under the Bank Holding Company Act as a result of the 1966 amendments differs in only one respect from the provisions applicable to the companies becoming bank holding companies in 1956. The tax-free treatment for companies covered by the 1966 amendments is made available only if all distributions made in kind—i.e., made in other than money—are made on a pro rata basis. Thus, no corporation, under this amendment, will be able to acquire the stock of some of its shareholders with assets in kind (and in this manner avoid any subsequent tax to the corporation on the appreciation in the value of these assets) while at the same time distributing other property in kind to other shareholders on a tax-free basis under the terms of this bill.

Under the bill as reported by your committee, the provisions described above apply to taxable years ending after July 1, 1966 (the date of enactment of the 1966 amendments to the Bank Holding Company Act of 1956).

III. MORTGAGE GUARANTY INSURANCE

Reasons for the provision.—Mortgage guaranty insurance companies guarantee the holder of a real estate mortgage against loss on its mortgage loan, in a manner somewhat comparable to the mortgage insurance written by FHA. However, FHA insures the entire amount of the mortgage, while mortgage guaranty insurance companies have an option to pay 20 percent of the face of the mortgage in full satisfaction of the liability. While as a practical matter 20-percent coverage presently may be sufficient to cover any likely loss on a defaulted mortgage, nevertheless in the event of a serious depression, that option may be significant. Moreover, FHA insures mortgages representing as much as 97 percent of the appraised value of the property, while mortgage guaranty insurance is not written on loans for more than 90 percent of the appraised value of the property. Premiums on these policies are sometimes paid in a lump sum when the contract is written, but in most cases, perhaps 80 percent, annual premiums are paid over the period of risk.

These private insurers are regulated by State insurance commissions. On the possibility that extraordinary losses may occur from mortgage defaults, for example in a depression, State insurance commissions regulating this industry generally require the company's establishment of a contingency loss reserve to protect against extraordinary losses. For example, under the regulations of one State commission, a guaranty company is required to add up to 50 percent of earned premiums to its contingency loss reserves.[2] These reserve additions are not related to loss experience and remain in the reserve for 15 years, in the absence of authorization from the State commission for prior restoration to income. Normal losses are charged to income currently, rather than to the reserve. The regulations of this particular State commission indicate that reserve invasions may be authorized when losses exceed, by more than 10 percent of premiums, the expected losses set forth in the rate formula. Unless losses

[2] On loans for 80 percent or more of the appraised value of the property, 50 percent of earned premiums must be added to the reserve. On loans of less than 80 percent, 30 percent of earned premiums is added to the reserve. The likelihood is that most loans covered by this insurance are for 80 percent or more of appraised value.

exceed 40 percent of premiums (30 percent in the rate formula plus the 10 percent margin) the reserve may not be invaded to meet current losses under the existing regulations of this State commission.

The typical life of a real estate mortgage is about 8 years, even though the mortgage may have been written for a 20-year life or longer (as a consequence of property transfers, mortgage loans on the average are paid off somewhat earlier than the original period of the loan). Even though there has been earlier payment in full of mortgage loans, and consequent termination of the need for the reserve, the State commission's regulations do not restore the reserve to income until after the entire 15-year period is passed.

Under section 832(b)(4) of the code a deduction is now allowed for contributions to a reserve for "unearned premiums." The Internal Revenue Service has defined unearned premiums as "that portion which the company has not yet had time to earn, or more precisely, that portion paid by the policyholder which must be returned on cancellation of the policy, and which is in direct proportion to the unexpired time which the policy is to run." In 1960 the Internal Revenue Service issued a ruling to a company writing mortgage guaranty insurance stating that its contingency loss reserve required by the State commission was a reserve for unearned premiums within the meaning of section 832(b)(4). A similar ruling was subsequently issued to another company. Since that time requests for similar rulings from other companies have been submitted to the Internal Revenue Service, but the Service has not ruled on the requests.

The Service has now decided that its original rulings of 1960 also should be changed, although it has not yet revoked them. The tax returns of 10 or more other companies which did not receive favorable rulings, however, are being held in suspense. These other companies contend that they are competitively handicapped, and their ability to obtain equity capital is prejudiced because they have not received a ruling similar to those issued in 1960. The Treasury Department believes that a legislative solution of the problem is desirable. Your committee agrees.

It is clear, where State law requires 50 percent of the earned premiums to be placed in a reserve for extraordinary losses, that it would be extremely difficult for any company to operate without continuing additions to working capital. Their current losses and other expenses amount to more than half of their earned premiums. If half of those premiums must be placed in reserve, some of the current expenses will have to be paid from working capital. A current tax on the earned premiums dedicated to the reserve will necessitate an even greater depletion of the working capital. Your committee's amendment is designed to solve this unique problem created by unusual State requirements, and to afford uniform treatment to all companies engaged in writing mortgage guaranty insurance.

While it is recognized that State law in these cases requires the set-aside of large amounts to cover these possible future losses, nevertheless, deductions of anything like 50 percent would be providing these companies deductions substantially in excess of what they presently can show is their actual loss experience. Should this present loss experience prove to be correct in the long run, deductions of these large reserves required by State law would permit substantial amounts to remain free of tax for a period of up to 15 years. This

would provide substantially more favorable treatment for these companies than is available for other businesses.

Because of the considerations set forth above, the committee has concluded that it is appropriate to permit these mortgage guaranty insurance companies to obtain a deduction for additions to these special reserves over the approximate average life of the mortgages guaranteed, but, at the same time, to deny them the earnings on the portion of such reserves representing deferred taxes during the time that portion is held for these special contingencies. The latter is accomplished by requiring the investment of the tax savings attributable to the deduction of reserve additions in non-interest-bearing Government bonds. The fact that the tax savings are invested in special bonds of the Federal Government means that the companies have assets for purposes of their statements which are recognized by State commissions and for accounting purposes.

Explanation of provision.—Under the committee amendment, deductions for additions to a reserve for mortgage guaranty insurance losses resulting from adverse economic cycles will be allowed, but not in excess of 50 percent of premiums earned during the year. Any amount added to the reserve must be restored to income at the close of 10 years (rather than 15 years as is generally required under State regulations). The deduction is not allowed, however, unless the company purchases a special issue of "tax and loss" Federal Government bonds in the amount of the tax benefit of the deduction. These bonds are to be noninterest bearing, nontransferable, and redeemable only when the amounts added to the reserve are restored to income. It is expected that these bonds will be recognized, by both accountants and State insurance commissions, as an asset for statement purposes. At the time of restoration of the reserve to income, the bonds purchased when the addition was made to the reserve may be utilized to pay the resulting income tax. If the company has no tax to pay in the year of redemption because of other deductions, the bonds would be redeemable for cash.

The committee's amendment is less favorable to the taxpayer than the rulings issued by the Internal Revenue Service in 1960, since any amounts added to the reserve must be restored to income at the end of 10 years (rather than 15 years) and the tax benefit from the deduction must be invested in non-interest-bearing Federal bonds.

The bill amends the Second Liberty Bond Act to authorize the Secretary of the Treasury to issue the non-interest-bearing bonds for the purposes of the new tax provisions described above.

While the amendment of the Internal Revenue Code is applicable to taxable years beginning after December 31, 1966, the committee's amendment (subsec. (g) of sec. 2 of the bill) provides special rules for additions made prior to 1967 to reserves for mortgage guaranty insurance losses. These special rules are designed to validate the deductions taken in past years by all companies that made additions to such reserves. As a result, all companies in the industry will be treated alike. Tax-and-loss bonds are not required for past years, but the additions to reserves made prior to 1967 must be included in income at the end of 10 years following the year for which the addition was made. In addition, losses incurred for taxable years beginning after 1966, to the extent the losses exceed 35 percent of earned premiums for the year, are to be charged to the pre-1967 reserve rather than against current income.

Technical explanation of provision.—Section 2 of the bill adds a new subsection (e) to section 832 of the Internal Revenue Code. The new subsection (e) provides special rules in the case of taxable years beginning after December 31, 1966, for a company which writes mortgage guaranty insurance. Such a company may be organized under a special State statute relating solely to such insurance companies or organized under a general statute relating to credit guaranty insurance companies.

Subparagraph (A) of the new subsection (e)(1) refers to a reserve which is in substance a contingency reserve for extraordinary or unusual mortgage guaranty insurance losses. Mortgage guaranty insurance companies are generally required by certain State statutes or regulations to set aside an amount, usually a certain portion of their premiums, for a definite period of time in such a reserve for unusual losses. Such a reserve is not available for general corporate purposes, but subject to the approval of the State insurance commissioner is available in the event that the losses of a company in any year exceed its "normal losses."

Except as otherwise provided, in order for the deduction to be allowed under new subsection (e)(1), tax-and-loss bonds referred to in new subsection (e)(2) shall be purchased on or before the date that any taxes (determined without regard to new subsec. (e)) due for the taxable year for which the deduction is allowed are due to be paid, as if no election to make installment payments under section 6152 is made. If a company would make payments of estimated tax if new subsection (e) did not apply, then whether or not such company pays estimated tax after the application of subsection (e), such bonds must be purchased on or before the date for paying such estimated tax in order for them to be considered purchased on or before the date that any taxes due for the taxable year are to be paid. If an obligation to make payments of estimated tax is eliminated by the allowance of the deduction under new subsection (e)(1), in order to qualify for such deduction the company is required to purchase these tax-and-loss bonds at the time the estimated tax payments are due to be paid and in the amount of such payments.

The Secretary of the Treasury is authorized under the bill to prescribe the terms and conditions under which such bonds shall be purchased, and may provide, for example, that deposits may be made toward the purchase of such bonds. At the time the company's tax return is filed, the deposits could be so applied, or to the extent not needed for such purchases or for the payment of the company's taxes, such amounts could be refunded to the company. In accordance with the provisions of new section 832(e)(1), all amounts are to be taken into account on a first-in-time basis, including for purposes of determining the deposits which have been applied to purchase bonds.

In computing the aggregate amount in the State reserve for purposes of new subsection (e)(5)(B), such amount shall be reduced, for example, by the amount of losses incurred which is permitted to be charged to such reserve under State law or regulation. Although under new subsection (e)(1) such a charge to the reserve does not affect the computation of losses incurred, such reserve, nevertheless, shall be reduced by the amount of such charge.

The application of new subsection (e) may be illustrated by the following example: Company A was organized on January 1, 1967, and is required by State law or regulation to set aside 50 percent of premiums earned on insurance contracts (as defined in sec. 832(b)(4)) with respect to mortgage guaranty insurance in a reserve referred to in new paragraph (1)(A). For 1967 the amount so set aside is $300*x*. However, company A's taxable income, computed without regard to the deduction allowed by new paragraph (1) or any carryback of a net operating loss, was only $100*x* and, thus, such deduction could not exceed $100*x*. By purchasing the amount of tax and loss bonds required by new paragraph (2) company A was allowed a deduction of $100*x* under new paragraph (1) for 1967 and reduced its taxable income to zero. Company A added $100*x* to its mortgage guaranty account.

In 1968 company A suffered a net operating loss computed without regard to new paragraph (5)(C) of $50*x*. Under State law or regulation company A was required to set aside $30*x* for 1968 in such reserve but was required to reduce such reserve by $75*x*, a net reduction of $45*x*. Consequently, for purposes of new paragraph (5)(B) the aggregate amount remaining in such reserve for 1968 was $255*x* ($300*x*+$30*x*−$75*x*). Since no deduction was allowed under new paragraph (1), because company A had no taxable income for 1968, no amount was added to the mortgage guaranty account for 1968. As a result, for purposes of new paragraph (5)(B) the aggregate amount in such account was $100*x*.

Since no amount can be added to company A's mortgage guaranty account for years prior to 1967, no amount is subtracted from such account or included in gross income for 1968 under new paragraph (5)(A) with respect to amounts added to such account for the 10th preceding taxable year. In addition, since for 1968 there is no excess of the aggregate amount in the mortgage guaranty account ($100*x*) over the aggregate amount ($255*x*) in the reserve referred to in new paragraph (1)(A), no amount is subtracted or so included in gross income under new paragraph (5)(B) for 1968.

However, $50*x* would be subtracted from the mortgage guaranty account and included in gross income for 1968 under new paragraph (5)(C), since in 1968 company A suffered a net operating loss of $50*x* computed without regard to new paragraph (5)(C). As a consequence, the inclusion of $50*x* in gross income under new paragraph (5)(C) offsets any net operating loss for 1968.

In this connection, it should be noted that section 26 of the Second Liberty Bond Act as added by section 2(f) of the bill provides in part that with respect to any taxable year in which amounts are subtracted from such mortgage guaranty account, an amount of tax and loss bonds which was purchased under new section 832(e)(2) with respect to the amount so subtracted shall be redeemed. In the above example, since $50*x* of the $100*x* which was allowed as a deduction in 1967 under new paragraph (1) was so subtracted in 1968, 50 percent ($50*x*/$100*x*) of the bonds so purchased in 1967 shall be redeemed. No amount, however, is subtracted under more than one subparagraph of new paragraph (5).

In determining the amount of the deduction under new paragraph (1) (as limited by taxable income computed without regard to such paragraph or any carryback), net operating loss carryovers or amounts which are subtracted from the mortgage guaranty account and in-

cluded in gross income for the taxable year under new paragraph (5) are, of course, taken into account.

Nothing in this bill shall be construed as requiring the Secretary of the Treasury to redeem tax and loss bonds as a result of improper subtractions under subparagraph (A), (B), or (C) of new paragraph (5). New subparagraph (D) only applies after such bonds have been redeemed. Such bonds, however, shall be treated as redeemed when applied to pay tax, buy other tax and loss bonds, or otherwise redeemed.

In order to qualify for this deduction under new section 832(e) a company is required to make timely payments or deposits toward the purchase of bonds. When payments or deposits are made before a company's tax return is filed, the Secretary of the Treasury would be authorized under the bill to delay issuing bonds until the company's tax return is filed, and then to issue bonds backdated to the date of the payments or deposits. The Secretary of the Treasury is also authorized to provide, for example, that payments or deposits not applied toward the purchase of bonds, or not otherwise used, will be returned to the company.

In general, the date (determined without regard to new sec. 832 (*e*)) on which such bonds may be redeemed is the due date of any tax due (other than estimated tax) for the taxable year for which an amount is so subtracted from the account and included in income. However, since subtraction from the mortgage guaranty account and inclusion in income are made under new subsection (e)(5)(A) with respect to amounts added to the account for the 10th preceding year, such bonds may be redeemed 10 years from the date purchased. Thus, if, for example, the Secretary of the Treasury requires a company to make deposits toward the purchase of bonds by the due date for paying estimated tax in order to qualify for the deduction under new subsection (e)(1), such bonds (unless redeemed for an earlier taxable year) may be redeemed 10 years from the date of the deposit to the extent of the deposit. In lieu of the application of tax due as a result of the inclusion of amounts in gross income under new section 832(b)(1)(E), the Secretary of the Treasury may permit the bonds to be redeemed to be applied toward the purchase of other tax and loss bonds.

Under the bill in special circumstances, the Secretary of the Treasury could redeem such bonds at an earlier date than would otherwise be the case. Such a special circumstance could be, for example, when a company suffers heavy losses and needs to pay claims with the proceeds from the redemption of such bonds.

A reserve described in subsection (g)(1) of section (2) of the bill would be a reserve of the type described in new section 832 (e)(1)(A).

Under the second and third sentences of subsection (g)(1) of section 2 of the bill, in determining, for example, the earned premiums for 1967, the amount of unearned premiums on outstanding business at the end of both 1966 and 1967 shall be computed without any amount which had been treated as unearned premiums under such subsection (g)(1).

Subsection (g) of section 2 of the bill may be illustrated as follows: For taxable years beginning before 1968, a company has added an aggregate of \$100*x* to such a reserve. However, pursuant to reductions ordered by a State insurance commissioner, the amount thereof which remains in the reserve at the close of 1968 is \$80*x*. For all taxable years beginning before 1967, \$100*x* was so treated as unearned

premiums, and for 1967, $\$7x$ had been included in gross income under such subsection (g)(2). For 1968, $\$5x$ is included in gross income under subparagraphs (A) and (B) of such subsection (g)(2). In applying subparagraph (C) to 1968 the aggregate amount so treated as unearned premiums for all taxable years beginning before 1967 ($\$100x$) less the total of the amounts included in gross income under subsection (g)(2) for prior taxable years ($\$7x$) and the amounts included in gross income under subparagraphs (A) and (B) for 1968 ($\$5x$) is $\$88x$ ($\$100x - \$12x$). The excess of such amount ($\$88x$) over the aggregate of the additions made for taxable years beginning before 1967 which remain in the reserve at the close of 1968 ($\$80x$) is $\$8x$ ($\$88x - \$80x$). Thus, $\$8x$ is so included in gross income under subparagraph (C).

Subsection (g)(2) further provides that for purposes of section 832 (e) of the code and of such subsection (g), if part of such reserve is reduced under State law or regulation, such reduction shall first apply to the extent of amounts added to the reserve for taxable years beginning before 1967, and only then to amounts added thereafter. As previously stated, the reserve referred to in subsection (g)(1) of the bill is the same reserve referred to in section 832(e)(1)(A) of the code as added by section 2(c) of the bill. Thus, a State insurance commissioner, for example, could order a reduction in such a reserve which contains amounts added to the reserve both for years prior to 1967 and subsequent to 1966. In such a case, subsection (g)(2) provides that a first-in-time rule shall apply. As a consequence, no amount which is included in income under such subsection (g)(2) shall also be included in income under new codes section 832(e)(5).

Amounts shall be included in gross income under such subsection (g) (2) in accordance with the usual limitations of section 111 of the code.

IV. UNFUNDED PENSION PLANS OF EDUCATIONAL AND OTHER TAX-EXEMPT ORGANIZATIONS

Extension of tax benefits to certain unfunded plans.—It has come to the committee's attention that some universities, whose assets and investments are sufficient so it is clear that their obligations to their employees would be met, find that they can provide more favorable pension benefits than those obtainable through the purchase of annuity contracts, if they merely make those benefits a charge upon their general funds. Such educational institutions should not be required to purchase commercial annuities in order to be able to provide pension benefits which receive favorable tax treatment for their employees. Accordingly, this amendment permits unfunded plans (which meet the requirements specified in the bill) to be treated as annuity contracts for certain tax purposes.

Section 3 of the bill, added by your committee extends the tax benefits referred to below to employees and their beneficiaries covered by unfunded retirement plans of universities and certain other tax-exempt organizations by treating these plans in the same manner as annuity contracts where certain specified conditions are met.

In the case of the income tax, treating these plans as if they were annuity contracts means that up to $5,000 of payments made upon the employee's death may be treated as nontaxable even though the employee before death had a vested right to the amount if the amount was received within 1 year by reason of his death. For purposes of

the estate tax the value of these qualifying annuities is not includible in the gross estate, to the same extent as though they were provided under an annuity contract. In the case of the gift tax the exercise of an option by the employee converting one of these qualifying annuities into a joint and survivor annuity is not treated as a transfer subject to gift tax to the same extent as though they were provided under an annuity contract.

An unfunded plan is one which has no segregated funding.[1] For this treatment to apply, the employees of the university or other organization must (1) have had the option to come under a comparable retirement plan funded by an annuity contract, and (2) the Secretary of the Treasury must have determined that the absence of funding has not materially jeopardized the ultimate payment of the benefits.

This provision applies to taxable years beginning after December 31, 1966, insofar as it relates to the income tax, to decedents dying after December 31, 1966, for estate tax purposes, and to transfers made after the calendar year 1966 for gift tax purposes.

Revision in the method of computing 20-percent limitation.—This amendment also deals with another problem under existing law. In the case of annuity contracts purchased by a tax-exempt educational, etc., organization for its employees where the contract is not purchased under a qualified plan, present law, nevertheless, permits an exclusion from these employees' income of amounts paid by the organization for the contracts to the extent the amounts do not exceed 20 percent of the compensation paid them. In the computation of this 20-percent limitation, present law takes into account not only amounts set aside under nonqualified plans (sec. 403(b) plans), but also amounts set aside under other annuity contracts as well. However, this 20-percent computation does not take into account amounts paid under nonqualified plans which are forfeitable and amounts promised under unfunded plans.

Your committee does not believe that Congress intended the amount set aside tax-free for the future retirement of an employee under any terms to equal more than 20 percent of the compensation paid the employee when part of it is provided under a tax sheltered annuity plan.

For the reasons given above, your committee has amended present law by providing that the value of the retirement benefits to be taken into account in determining the subtractions to be made from the amount to be excludable under the 20-percent provision are to include the value of all retirement benefits, forfeitable and nonforfeitable, funded and unfunded which were not includable in the gross income of the employee for any prior year. The value of the retirement benefits provided by the employer for purposes of this computation is to be determined by regulation but this value, in effect, is not to be greater than the amounts which would have been contributed by the employer under a funded annuity contract.

This provision applies to taxable years beginning after December 31, 1967.

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[1] A separate credit on the books of the university does not make a plan funded, for these purposes.

V. INVESTMENT CREDIT CARRYBACKS RESULTING FROM NET OPERATING LOSS CARRYBACKS

Reasons for provisions.—Under present law, a taxpayer claiming the investment credit may lose the benefit of the credit which he has already taken in a year if he incurs a net operating loss in a subsequent year which is carried back to the year in question. In this case, to the extent the net operating loss carryback eliminates, or reduces, the taxpayer's tax liability before the allowance of the investment credit, the benefit of this investment credit is lost except to the extent the taxpayer can use this as an investment credit carryover to a subsequent year. While the investment credit in this case can be used in a subsequent year, this, of course, does a taxpayer no good unless he has taxable income in the subsequent year.

This result is incompatible with the achievement of parity among similarly situated taxpayers. It discriminates against a taxpayer who has income in one year which is offset by a loss in a subsequent year. Other taxpayers may have investment credit carrybacks yet no more income over a period of years than the first taxpayer.

This is illustrated by a comparison of the following two cases:

Case No. 1: Assume that the taxable income of a taxpayer as shown on his return for 1966 is $2 million. Assume also that his investment credit for that year is $200,000 and that he is subject to a flat 50 percent tax rate for that year. (A flat 50 percent tax rate is assumed for ease of illustration.) The tax due before any investment credit in this case would be $1 million. Since the $200,000 investment credit is less than 25 percent of the tax due, the whole $200,000 would be initially allowed as a credit in that year reducing the tax payment to $800,000. If the taxpayer has a net operating loss carryback from 1967 to 1966 of $2 million, his taxable income for 1966 would be eliminated by the application of the net operating loss carryback. This would also mean that the $200,000 investment credit which had been allowed for 1966 could not be used. Under existing law, this $200,000 unused investment credit could not be carried back to a year earlier than 1966. It would be available only as a carryforward to a year after 1966. This, of course, would do the taxpayer no good if he had no taxable income during the carryforward period (7 years) or, if he was struggling to keep his business going, would do him very little good insofar as his financial credit status is concerned because of the uncertainty as to whether he would have taxable income in a subsequent year.

Case No. 2: Assume that in 1966 the taxpayer had no taxable income to begin with. In this case, if the taxpayer makes an investment resulting in an investment credit of $200,000, he could carry the credit back to a year before 1966, offset tax liability in the earlier year and obtain a refund of $200,000. In this case, the money would be in the taxpayer's hands in 1966 and could be used to improve his financial position in subsequent years. He would not have to wait to determine whether this $200,000 could be used as an offset to tax liability for a subsequent year.

As can be seen in these two cases, even though the taxable income of the two taxpayers in the years 1966 and 1967 was zero in both cases and, consequently, the tax liability in those years was zero; never-

theless, the taxpayer who had the net operating loss in 1967 which eliminated his income in 1966, would not be allowed to carry the $200,000 investment credit to a year before 1966. On the other hand, the taxpayer who initially had no income in 1966 would be permitted to carry the $200,000 investment credit back to a year before 1966 and could receive a refund of up to $200,000 through the reduction of the earlier year's tax.

For the reasons given above your committee's amendment modifies existing law to make the investment credit carryback available for an investment credit initially allowable for a year which, by reason of a net operating loss carryback to that year, subsequently cannot be taken in that year.

Explanation of provision.—Present law specifically provides that where the carryback of a net operating loss produces an unused investment credit for the year to which the loss is carried, the investment credit carryback provisions do not apply. As a result, a taxpayer in this situation can only obtain the benefits of such an unused credit by carrying it forward to subsequent years. Your committee's amendment repeals this special limitation on the availability of an investment credit carryback. Under the amendment, a taxpayer who has an unused investment credit for a year which results from a net operating carryback loss to that year is to be permitted to carry the unused credit to the three preceding taxable years, as is permitted with respect to unused investment credits generally.

Since these earlier years would ordinarily have become closed by the running of the statutory periods of limitations, the bill also amends present law to keep these years open for assessment and refund purposes in these cases. The period for assessment is extended by the bill only with respect to deficiencies directly attributable to the investment credit carryback. Where a tentative carryback adjustment of tax is claimed (the so-called quickie refund) as a result of the investment credit carryback permitted by your committee's amendment, a provision of existing law (not amended by the bill) would permit an assessment of a deficiency for the year to which the credit is carried, but only to the extent of the amount of the credit that was allowed for that year under the claim. In the cases covered by the amendment, interest will not be paid for years prior to the year in which the net operating loss occurred. Similarly, the amendment will not stop the running of interest on underpayments of income tax for the year to which the investment credit carryback is carried prior to the end of the year in which the net operating loss arose.

This amendment applies to investment credit carrybacks attributable to the carryback of net operating losses sustained in taxable years ending after June 30, 1967.

VI. SPIN-OFF OF LIFE INSURANCE COMPANY

Reasons for provisions.—The Life Insurance Company Income Tax Act of 1959 provides that a life insurance company is to hold a certain portion of its earnings untaxed in a "policyholders surplus account." However, any distribution out of this account to the shareholders gives rise to the so-called phase III tax on life insurance companies; that is, the deferred tax will then become due and payable. Included in the distributions which may give rise to this tax are distributions in redemption of stock, distributions in partial liquidation, and a

distribution of stock of a subsidiary in a spinoff (distribution of the subsidiary's stock to the shareholders of the life insurance company) which is tax free to the shareholders receiving the stock. However, in the past, limited exceptions have been made to the rule with regard to spinoffs. In 1962, in Public Law 87–858, an amendment was adopted permitting a life insurance company to distribute the stock of a controlled fire and casualty insurance subsidiary without any phase III tax if such subsidiary was acquired in a tax-free stock-for-stock exchange (under sec. 368(a)(1)(B)) prior to January 1, 1963. In 1964, in Public Law 88–571, this exception was extended to cover the spinoff of a fire or casualty subsidiary in all cases where the subsidiary was 80 percent or more owned before January 1, 1958 (the effective date of the Life Insurance Company Income Tax Act of 1959) without regard to how control of the subsidiary was acquired. The House committee report at that time pointed out that a subsidiary acquired before the act of 1959 was applicable must of necessity have been acquired with earnings which were not subject to tax under that act. However, present law does not cover the distribution of the stock of a subsidiary which is a life insurance company regardless of when or how control of such subsidiary was acquired.

A case has come to the attention of your committee in which a life insurance company owns all the stock of another life insurance company. It appears probable that under present law if the parent insurance company qualifies to do business in a particular State, the life insurance authorities of that State will also assert control over the affairs of the subsidiary (although the subsidiary sells no insurance in that State). Also in some States there may be legal restrictions on the ownership of all the stock of one life insurance company by another life insurance company. To deal with these problems and for other business reasons, it is desired to change the parent-subsidiary corporations into brother-sister corporations. It is planned to do this by having all the shareholders of the parent corporation exchange all their stock in the parent for the stock of a new holding company. Thereafter, the parent life insurance company will distribute the stock of its subsidiary life insurance company to the holding company (in a section 355 spinoff).

The subsidiary in the case called to the committee's attention has been owned by the parent since long before the enactment of the 1959 act. Moreover, there is a difference between stock in an insurance subsidiary and other types of assets which are generally held by insurance companies as investments. The stock of an insurance subsidiary ordinarily produces a low yield. For this reason, this stock would not usually be held by life insurance companies for investment purposes. In these circumstances, your committee believes relief is appropriate.

This amendment is expected to have only a negligible effect on revenues.

Explanation of provisions.—The amendment made by your committee applies in cases in which, before the distribution of stock, a holding company owns all the stock of a first-tier life insurance subsidiary which, in turn, owns all the stock of a second-tier life insurance subsidiary. In such a case a distribution by the first-tier subsidiary of the stock of the second-tier subsidiary to the parent holding company, where the distribution is tax free (under section 355) is not to give rise to any phase III tax for the first-tier subsidiary if 80 percent of the

stock of the second-tier subsidiary was owned at all times since December 31, 1957, by the first-tier subsidiary. The amendment provides that to the extent contributions to capital were made after December 31, 1957, the amount of these contributions will be subject to the phase III tax on the distribution of the stock of the subsidiary.

The amendment is to apply to distributions made after December 31, 1966.

VII. CHANGES IN EXISTING LAW

In compliance with subsection (4) of rule XXIX of the Standing Rules of the Senate, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

INTERNAL REVENUE CODE OF 1954

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SEC. 46. AMOUNT OF CREDIT.

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(b) CARRYBACK AND CARRYOVER OF UNUSED CREDITS—

(1) ALLOWANCE OF CREDIT.—If the amount of the credit determined under subsection (a)(1) for any taxable year exceeds the limitation provided by subsection (a)(2) for such taxable year (hereinafter in this subsection referred to as "unused credit year"), such excess shall be—

(A) an investment credit carryback to each of the 3 taxable years preceding the unused credit year, and

(B) an investment credit carryover to each of the 7 taxable years following the unused credit year,

and shall be added to the amount allowable as a credit by section 38 for such years, except that such excess may be a carryback only to a taxable year ending after December 31, 1961. The entire amount of the unused credit for an unused credit year shall be carried to the earliest of the 10 taxable years to which (by reason of subparagraphs (A) and (B)) such credit may be carried, and then to each of the other 9 taxable years to the extent that, because of the limitation contained in paragraph (2), such unused credit may not be added for a prior taxable year to which such unused credit may be carried.

(2) LIMITATION.—The amount of the unused credit which may be added under paragraph (1) for any preceding or succeeding taxable year shall not exceed the amount by which the limitation provided by subsection (a)(2) for such taxable year exceeds the sum of—

(A) the credit allowable under subsection (a)(1) for such taxable year, and

(B) the amounts which, by reason of this subsection, are added to the amount allowable for such taxable year and attributable to taxable years preceding the unused credit year.

[(3) EFFECT OF NET OPERATING LOSS CARRYBACK.—To the extent that the excess described in paragraph (1) arises by reason

of a net operating loss carryback, subparagraph (A) of paragraph (1) shall not apply.]

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SEC. 101. CERTAIN DEATH BENEFITS.

* * * * * * *

(b) EMPLOYEES' DEATH BENEFITS.—

(1) GENERAL RULE.—Gross income does not include amounts received (whether in a single sum or otherwise) by the beneficiaries or the estate of an employee, if such amounts are paid by or on behalf of an employer and are paid by reason of the death of the employee.

(2) SPECIAL RULES FOR PARAGRAPH (1)—

(A) $5,000 LIMITATION.—The aggregate amounts excludable under paragraph (1) with respect to the death of any employee shall not exceed $5,000.

(B) NONFORFEITABLE RIGHTS.—Paragraph (1) shall not apply to amounts with respect to which the employee possessed, immediately before his death, a nonforfeitable right to receive the amounts while living. This subparagraph shall not apply to total distributions payable (as defined in section 402(a)(3)) which are paid to a distributee within one taxable year of the distributee by reason of the employee's death—

(i) by a stock bonus, pension, or profit-sharing trust described in section 401(a) which is exempt from tax under section 501(a),

(ii) under an annuity contract under a plan described in section 403(a), or

(iii) under an annuity contract purchased by an employer which is an organization referred to in section 503(b)(1), (2), or (3) and which is exempt from tax under section 501(a), but only with respect to that portion of such total distributions payable which bears the same ratio to the amount of such total distributions payable which is (without regard to this subsection) includible in gross income, as the amounts contributed by the employer for such annuity contract which are excludable from gross income under section 403(b) bear to the total amounts contributed by the employer for such annuity contract. *For purposes of this clause, a retirement plan described in subparagraph (E) of an employer shall, under regulations prescribed by the Secretary or his delegate, be treated as an annuity contract to which section 403(b) applied purchased by such employer.*

* * * * * * *

(E) CERTAIN RETIREMENT PLANS.—For purposes of subparagraph (B), a retirement plan referred to in clause (iii) is, with respect to any employee, only a retirement plan—

(i) which provided for payment of retirement benefits by the employer with respect to which no amount was set aside,

(ii) with respect to which the employee was (before any benefits accrued to him under such plan) given an election to have comparable benefits provided under an annuity

contract to which section 403(b) applied (or would have applied), in lieu of benefits provided under such plan, and

(iii) with respect to which there was in effect, at the time such employee elected to have benefits provided under such plan, a determination by the Secretary or his delegate that payments of benefits by the employer under such plan were not materially jeopardized by the failure of the employer to set aside amounts to provide for such payments.

* * * * * * *

SEC. 381. CARRYOVERS IN CERTAIN CORPORATE ACQUISITIONS.

(a) GENERAL RULE.—In the case of the acquisition of assets of a corporation by another corporation—

(1) in a distribution to such other corporation to which section 332 (relating to liquidations of subsidiaries) applies, except in a case in which the basis of the assets distributed is determined under section 334(b)(2); or

(2) in a transfer to which section 361 (relating to nonrecognition of gain or loss to corporations) applies, but only if the transfer is in connection with a reorganization described in subparagraph (A), (C), (D) (but only if the requirements of subparagraphs (A) and (B) of section 354(b)(1) are met), or (F) of section 368(a)(1).

the acquiring corporation shall succeed to and take into account, as of the close of the day of distribution or transfer, the items described in subsection (c) of the distributor or transferor corporation, subject to the conditions and limitations specified in subsections (b) and (c).

* * * * * * *

(c) ITEMS OF THE DISTRIBUTOR OR TRANSFEROR CORPORATION.—The items referred to in subsection (a) are:

* * * * * * *

[(22) SUCCESSOR LIFE INSURANCE COMPANY.—If the acquiring corporation is a life insurance company (as defined in section 801(a)), there shall be taken into account (to the extent proper to carry out the purposes of this section and part I of subchapter L, and under such regulations as may be prescribed by the Secretary or his delegate) the items required to be taken into account for purposes of part I of subchapter L (relating to life insurance companies) in respect of the distributor or transferor corporation.]

(22) SUCCESSOR INSURANCE COMPANY.—If the acquiring corporation is an insurance company taxable under subchapter L, there shall be taken into account (to the extent proper to carry out the purposes of this section and of subchapter L, and under such regulations as may be prescribed by the Secretary or his delegate) the items required to be taken into account for purposes of subchapter L in respect of the distributor or transferor corporation.

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SEC. 403. TAXATION OF EMPLOYEE ANNUITIES.

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(b) TAXABILITY OF BENEFICIARY UNDER ANNUITY PURCHASED BY SECTION 501(c)(3) ORGANIZATION OR PUBLIC SCHOOL.—

(1) GENERAL RULE.—If—

(A) an annuity contract is purchased—

(i) for an employee by an employer described in section 501 (c)(3) which is exempt from tax under section 501(a), or

(ii) for an employee (other than an employee described in clause (i)), who performs services for an educational institution (as defined in section 151(e)(4)), by an employer which is a State, a political subdivision of a State, or an agency or instrumentality of any one or more of the foregoing,

(B) such annuity contract is not subject to subsection (a), and

(C) the employee's rights under the contract are nonforfeitable, except for failure to pay future premiums,

then amounts contributed by such employer for such annuity contract on or after such rights become nonforfeitable shall be excluded from the gross income of the employee for the taxable year to the extent that the aggregate of such amounts does not exceed the exclusion allowance for such taxable year. The employee shall include in his gross income the amounts received under such contract for the year received as provided in section 72 (relating to annuities).

(2) EXCLUSION ALLOWANCE.—For purposes of this subsection, the exclusion allowance for any employee for the taxable year is an amount equal to the excess, if any, of—

(A) the amount determined by multiplying (i) 20 percent of his includible compensation, by (ii) the number of years of service, over

[(B) the aggregate of the amounts contributed by the employer for annuity contracts and excludable from the gross income of the employee for any prior taxable year.]

(B) the value of retirement benefits (whether forfeitable or nonforfeitable) to be provided by the employer which was not includible in the gross income of the employee for any prior taxable year.

For purposes of subparagraph (B), the value of retirement benefits to be provided by the employer shall be determined in accordance with regulations prescribed by the Secretary or his delegate, but such value at the close of any taxable year shall not be greater than the aggregate of the level amounts which would have been contributed by the employer during prior taxable years in order to provide such benefits, if contributions had been made by the employer during such years.

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SEC. 815. DISTRIBUTIONS TO SHAREHOLDERS.

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(f) DISTRIBUTION DEFINED.—For purposes of this section the term "distribution" includes any distribution in redemption of stock or in partial or complete liquidation of the corporation but does not include—

(1) any distribution made by the corporation in its stock or in rights to acquire its stock;

(2) except for purposes of subsection (a)(3) and subsection (e)(2)(B) any distribution in redemption of stock issued before 1958 which at all times on and after the date of issuance and on and before the date of redemption is limited as to dividends and is callable at the option of the issuer at a price not in excess of 105 percent of the sum of the issue price and the amount of any contribution to surplus made by the original purchaser at the time of his purchase; [or]

(3) any distribution after December 31, 1963 of the stock of a controlled corporation to which section 355 applies, if such controlled corporation is an insurance company subject to the tax imposed by section 831 and if—

(A) control was acquired prior to January 1, 1958, or

(B) control has been acquired after December 31, 1957—

(i) in a transaction qualifying as a reorganization under section 368(a)(1)(B), if the distributing corporation has at all times since December 31, 1957, owned stock representing not less than 50 percent of the total combined voting power of all classes of stock entitled to vote, and not less than 50 percent of the value of all classes of stock, of the controlled corporation, or

(ii) solely in exchange for stock of the distributing corporation which stock is immediately exchanged by the controlled corporation in a transaction qualifying as a reorganization under section 368(a)(1) (A) or (C), if the controlled corporation has at all times since its organization been wholly owned by the distributing corporation and the distributing corporation has at all times since December 31, 1957, owned stock representing not less than 50 percent of the total combined voting power of all classes of stock entitled to vote, and not less than 50 percent of the value of all classes of stock, of the corporation the assets of which have been transferred to the controlled corporation in section 368(a)(1) (A) or (C) [reorganization] *reorganization, or*

(4) any distribution after December 31, 1966, of the stock of a controlled corporation to which section 355 applies, if such distribution is made to a corporation which immediately after the distribution is in control (within the meaning of section 368(c)) of both the distributing corporation and such controlled corporation and if such controlled corporation is a life insurance company of which the distributing corporation has been in control at all times since December 31, 1957.

[Paragraph (3) shall not] *Neither paragraph (3) nor paragraph (4) shall* apply to that portion of the distribution of stock of the controlled corporation equal to the increase in the aggregate adjusted basis of such stock after December 31, 1957, except to the extent such increase results from an acquisition of stock in the controlled corporation in a transaction described in [subparagraph (B) of such paragraph] *paragraph (3)(B)*. If any part of the increase in the aggregate adjusted basis of stock of the controlled corporation after December 31, 1957, results from the transfer (other than as part of a transaction described in paragraph 3(B)) by the distributing corporation to the controlled corporation of property which has a fair market value in excess of its adjusted basis at the time of the transfer, [paragraph (3)] *paragraphs*

(3) and (4) also shall not apply to that portion of the distribution equal to such excess.

* * * * * * *

SEC. 832. INSURANCE COMPANY TAXABLE INCOME

(a) DEFINITION OF TAXABLE INCOME.—In the case of an insurance company subject to the tax imposed by section 831, the term "taxable income" means the gross income as defined in subsection (b)(1) less the deductions allowed by subsection (c).

(b) DEFINITIONS.—In the case of an insurance company subject to the tax imposed by section 831—

(1) GROSS INCOME.—The term "gross income" means the sum of—

(A) the combined gross amount earned during the taxable year, from investment income and from underwriting income as provided in this subsection, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners,

(B) gain during the taxable year from the sale or other disposition of property,

(C) all other items constituting gross income under subchapter B, except that, in the case of a mutual fire insurance company described in section 831(a)(3)(A), the amount of single deposit premiums paid to such company shall not be included in gross income, [and]

(D) in the case of a mutual fire or flood insurance company described in section 831(a)(3)(B), an amount equal to 2 percent of the premiums earned on insurance contracts during the taxable year with respect to policies described in section 831(a)(3)(B) after deduction of premium deposits returned or credited during the same taxable [year.] *year, and*

(E) in the case of a company which writes mortgage guaranty insurance, the amount required by subsection (e)(5) to be subtracted from the mortgage guaranty account.

* * * * * * *

(c) DEDUCTIONS ALLOWED.—In computing the taxable income of an insurance company subject to the tax imposed by section 831, there shall be allowed as deductions:

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(13) in the case of a company which writes mortgage guaranty insurance, the deduction allowed by subsection (e).

* * * * * * *

(e) SPECIAL DEDUCTION AND INCOME ACCOUNT.—In the case of taxable years beginning after December 31, 1966, of a company which writes mortgage guaranty insurance—

(1) ADDITIONAL DEDUCTION.—There shall be allowed as a deduction for the taxable year, if bonds are purchased as required by paragraph (2), the sum of—

(A) an amount representing the amount required by State law or regulation to be set aside in a reserve for mortgage guaranty insurance losses resulting from adverse economic cycles; and

(B) an amount representing the aggregate of amounts so set aside in such reserve for the 8 preceding taxable years to the extent such amounts were not deducted under this paragraph in such preceding taxable years,

except that the deduction allowable for the taxable year under this paragraph shall not exceed the taxable income for the taxable year computed without regard to this paragraph or to any carryback of a net operating loss. For purposes of this paragraph, the amount required by State law or regulation to be so set aside in any taxable year shall not exceed 50 percent of premiums earned on insurance contracts (as defined in subsection (b)(4)) with respect to mortgage guaranty insurance for such year. For purposes of this subsection all amounts shall be taken into account on a first-in-time basis. The computation and deduction under this section of losses incurred (including losses resulting from adverse economic cycles) shall not be affected by the provisions of this subsection. For purposes of this subsection the terms "preceding taxable years" and "preceding taxable year" shall not include taxable years which began before January 1, 1967.

(2) PURCHASE OF BONDS.—The deduction under paragraph (1) shall be allowed only to the extent that tax and loss bonds are purchased in an amount equal to the tax benefit attributable to such deduction, as determined under regulations prescribed by the Secretary or his delegate, on or before the date that any taxes (determined without regard to this subsection) due for the taxable year for which the deduction is allowed are due to be paid, as if no election to make installment payments under section 6152 is made. If a deduction would be allowed but for the fact that tax and loss bonds were not timely purchased, such deduction shall be allowed to the extent such purchases are made within a reasonable time, as determined by the Secretary or his delegate, if all interest and penalties, computed as if this sentence did not apply, are paid.

(3) MORTGAGE GUARANTY ACCOUNT.—Each company which writes mortgage guaranty insurance shall, for purposes of this part, establish and maintain a mortgage guaranty account.

(4) ADDITIONS TO ACCOUNT.—There shall be added to the mortgage guaranty account for each taxable year an amount equal to the amount allowed as a deduction for the taxable year under paragraph (1).

(5) SUBTRACTIONS FROM ACCOUNT AND INCLUSION IN GROSS INCOME.—After applying paragraph (4), there shall be subtracted for the taxable year from the mortgage guaranty account and included in gross income—

(A) the amount (if any) remaining which was added to the account for the tenth preceding taxable year, and

(B) the excess (if any) of the aggregate amount in the mortgage guaranty account over the aggregate amount in the reserve referred to in paragraph (1)(A). For purposes of determining such excess, the aggregate amount in the mortgage guaranty account shall be determined after applying subparagraph (A), and the aggregate amount in the reserve referred to in paragraph (1)(A) shall be determined by disregarding any amounts remaining in such reserve added for taxable years beginning before January 1, 1967.

(C) an amount (if any) equal to the net operating loss for the taxable year computed without regard to this subparagraph, and

(D) any amount improperly subtracted from the account under subparagraph (A), (B) or (C) to the extent that tax and loss bonds were redeemed with respect to such amount.

If a company liquidates or otherwise terminates its mortgage guaranty insurance business and does not transfer or distribute such business in an acquisition of assets referred to in section 381(a), the entire amount remaining in such account shall be subtracted. Except in the case where a company transfers or distributes its mortgage guaranty insurance in an acquisition of assets referred to in section 381(a), if the company is not subject to the tax imposed by section 831 for any taxable year, the entire amount in the account at the close of the preceding taxable year shall be subtracted from the account in such preceding taxable year.

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PART VIII—DISTRIBUTIONS PURSUANT TO BANK HOLDING COMPANY ACT OF 1956

Sec. 1101. Distributions pursuant to Bank Holding Company Act of 1956.
Sec. 1102. Special rules.
Sec. 1103. Definitions.

SEC. 1101. DISTRIBUTIONS PURSUANT TO BANK HOLDING COMPANY ACT OF 1956.

(a) DISTRIBUTIONS OF CERTAIN NON-BANKING PROPERTY.—

(1) DISTRIBUTIONS OF PROHIBITED PROPERTY.—If—

(A) a qualified bank holding corporation distributes prohibited property (other than stock received in an exchange to which subsection (c) (2) applies)—

(i) to a shareholder (with respect to its stock held by such shareholder), without the surrender by such shareholder of stock in such corporation; or

(ii) to a shareholder, in exchange for its preferred stock; or

(iii) to a security holder, in exchange for its securities; and

(B) the Board has, before the distribution, certified that the distribution of such prohibited property is necessary or appropriate to effectuate section 4 of the Bank Holding Company Act of 1956,

then no gain to the shareholder or security holder from the receipt of such property shall be recognized.

(2) DISTRIBUTIONS OF STOCK AND SECURITIES RECEIVED IN AN EXCHANGE TO WHICH SUBSECTION (c) (2) APPLIES.—If—

(A) a qualified bank holding corporation distributes—

(i) common stock received in an exchange to which subsection (c) (2) applies to a shareholder (with respect to its stock held by such shareholder), without the surrender by such shareholder of stock in such corporation; or

(ii) common stock received in an exchange to which subsection (c)(2) applies to a shareholder, in exchange for its common stock; or

(iii) preferred stock or common stock received in an exchange to which subsection (c)(2) applies to a shareholder, in exchange for its preferred stock; or

(iv) securities or preferred or common stock received in an exchange to which subsection (c)(2) applies to a security holder, in exchange for its securities; and

(B) any preferred stock received has substantially the same terms as the preferred stock exchange, and any securities received have substantially the same terms as the securities exchanged,

then, except as provided in subsection (f), no gain to the shareholder or security holder from the receipt of such stock or such securities or such stock and securities shall be recognized.

(3) NON PRO RATA DISTRIBUTIONS.—Paragraphs (1) and (2) shall apply to a distribution whether or not the distribution is pro rata with respect to all of the shareholders of the distributing qualified bank holding corporation.

(4) EXCEPTION.—This subsection shall not apply to any distribution by a corporation which has made any distribution pursuant to subsection (b).

(5) DISTRIBUTIONS INVOLVING GIFT OR COMPENSATION.—

In the case of a distribution to which paragraph (1) or (2) applies, but which—

(A) results in a gift, see section 2501, and following, or

(B) has the effect of the payment of compensation, see section 61(a)(1).

(b) CORPORATION CEASING TO BE A BANK HOLDING COMPANY.—

(1) DISTRIBUTIONS OF PROPERTY WHICH CAUSE A CORPORATION TO BE A BANK HOLDING COMPANY.—If—

(A) a qualified bank holding corporation distributes property (other than stock received in an exchange to which subsection (c) (3) applies)—

(i) to a shareholder (with respect to its stock held by such shareholder), without the surrender by such shareholder of stock in such corporation; or

(ii) to a shareholder, in exchange for its preferred stock; or

(iii) to a security holder, in exchange for its securities; and

(B) the Board has, before the distribution, certified that—

(i) such property is all or part of the property by reason of which such corporation controls (within the meaning of section 2 (a) of the Bank Holding Company Act of 1956) a bank or bank holding company, or such property is part of the property by reason of which such corporation did control a bank or a bank holding company before any property of the same kind was distributed under this subsection or exchanged under subsection (c) (3); and

(ii) the distribution is necessary or appropriate to effectuate the policies of such Act,

then no gain to the shareholder or security holder from the receipt of such property shall be recognized.

(2) DISTRIBUTIONS OF STOCK AND SECURITIES RECEIVED IN AN EXCHANGE TO WHICH SUBSECTION (c)(3) APPLIES.—If—

(A) a qualified bank holding corporation distributes—

(i) common stock received in an exchange to which subsection (c)(3) applies to a shareholder (with respect to its stock held by such shareholder), without the surrender by such shareholder of stock in such corporation; or

(ii) common stock received in an exchange to which subsection (c)(3) applies to a shareholder, in exchange for its common stock; or

(iii) preferred stock or common stock received in an exchange to which subsection (c)(3) applies to a shareholder, in exchange for its preferred stock; or

(iv) securities or preferred or common stock received in an exchange to which subsection (c) (3) applies to a security holder, in exchange for its securities; and

(B) any preferred stock received has substantially the same terms as the preferred stock exchanged, and any securities received have substantially the same terms as the securities exchanged,

then, except as provided in subsection (f), no gain to the shareholder or security holder from the receipt of such stock or such securities or such stock and securities shall be recognized.

(3) NON PRO RATA DISTRIBUTIONS.—Paragraphs (1) and (2) shall apply to a distribution whether or not the distribution is pro rata with respect to all of the shareholders of the distributing qualified bank holding corporation.

(4) EXCEPTION.—This subsection shall not apply to any distribution by a corporation which has made any distribution pursuant to subsection (a).

(5) DISTRIBUTIONS INVOLVING GIFT OR COMPENSATION.—

In the case of a distribution to which paragraph (1) or (2) applies, but which—

(A) results in a gift, see section 2501, and following, or

(B) has the effect of the payment of compensation, see section 61(a)(1):

(c) PROPERTY ACQUIRED AFTER MAY 15, 1955.—

(1) IN GENERAL.—Except as provided in paragraphs (2) and (3), subsection (a) or (b) shall not apply to—

(A) any property acquired by the distributing corporation after May 15, 1955, unless (i) gain to such corporation with respect to the receipt of such property was not recognized by reason of subsection (a) or (b), or (ii) such property was received by it in exchange for all of its stock in an exchange to which paragraph (2) or (3) applies, or (iii) such property was acquired by the distributing corporation in a transaction in which gain was not recognized under section 305(a) or section 332, or under section 354 with respect to a reorganization described in section 368(a)(1) (E) or (F), or

(B) any property which was acquired by the distributing corporation in a distribution with respect to stock acquired by such corporation after May 15, 1955, unless such stock was acquired by such corporation (i) in a distribution (with respect to stock held by it on May 15, 1955, or with respect

to stock in respect of which all previous applications of this clause are satisfied) with respect to which gain to it was not recognized by reason of subsection (a) or (b), or (ii) in exchange for all of its stock in an exchange to which paragraph (2) or (3) applies, or (iii) in a transaction in which gain was not recognized under section 305(a) or section 332, or under section 354 with respect to a reorganization described in section 368(a)(1) (E) or (F), or

(C) any property acquired by the distributing corporation in a transaction in which gain was not recognized under section 332 unless such property was acquired from a corporation which, if it had been a qualified bank holding corporation, could have distributed such property under subsection (a)(1) or (b)(1).

(2) EXCHANGES INVOLVING PROHIBITED PROPERTY.—If—

(A) Any qualified bank holding corporation exchanges (i) property which, under subsection (a)(1), such corporation could distribute directly to its shareholders or security holders without the recognition of gain to such shareholders or security holders, and other property (except property described in subsection (b)(1)(B)(i), for (ii) all of the stock of a second corporation created and availed of solely for the purpose of receiving such property;

(B) immediately after the exchange, the qualified bank holding corporation distributes all of such stock in a manner prescribed in subsection (a)(2)(A); and

(C) before such exchange, the Board has certified (with respect to the property exchanged which consists of property which, under subsection (a)(1), such corporation could distribute directly to its shareholders or security holders without the recognition of gain) that the exchange and distribution are necessary or appropriate to effectuate section 4 of the Bank Holding Company Act of 1956,

then paragraph (1) shall not apply with respect to such distribution.

(3) EXCHANGES INVOLVING INTERESTS IN BANKS.—If—

(A) any qualified bank holding corporation exchanges (i) property which, under subsection (b)(1), such corporation could distribute directly to its shareholders or security holders without the recognition of gain to such shareholders or security holders, and other property (except prohibited property), for (ii) all of the stock of a second corporation created and availed of solely for the purpose of receiving such property;

(B) immediately after the exchange, the qualified bank holding corporation distributes all of such stock in a manner prescribed in subsection (b)(2)(A); and

(C) before such exchange, the Board has certified (with respect to the property exchanged which consists of property which, under subsection (b)(1), such corporation could distribute directly to its shareholders or security holders without the recognition of gain) that—

(i) such property is all or part of the property by reason of which such corporation controls (within the meaning of section 2(a) of the Bank Holding Company Act of 1956) a bank or bank holding company,

or such property is part of the property by reason of which such corporation did control a bank or a bank holding company before any property of the same kind was distributed under subsection (b)(1) or exchanged under this paragraph; and

(ii) the exchange and distribution are necessary or appropriate to effectuate the policies of such Act,

then paragraph (1) shall not apply with respect to such distribution.

(d) DISTRIBUTIONS TO AVOID FEDERAL INCOME TAX.—

(1) PROHIBITED PROPERTY.—Subsection (a) shall not apply to a distribution if, in connection with such distribution, the distributing corporation retains, or transfers after May 15, 1955, to any corporation, property (other than prohibited property) as part of a plan one of the principal purposes of which is the distribution of the earnings and profits of any corporation.

(2) BANKING PROPERTY.—Subsection (b) shall not apply to a distribution if, in connection with such distribution, the distributing corporation retains, or transfers after May 15, 1955, to any corporation, property (other than property described in subsection (b)(1)(B)(i)) as part of a plan one of the principal purposes of which is the distribution of the earnings and profits of any corporation.

(3) CERTAIN CONTRIBUTIONS TO CAPITAL.—In the case of a distribution a portion of which is attributable to a transfer which is a contribution to the capital of a corporation, made after May 15, 1955, and prior to the date of the enactment of this part, if subsection (a) or (b) would apply to such distribution but for the fact that, under paragraph (1) or (2) (as the case may be) of this subsection, such contribution to capital is part of a plan one of the principal purposes of which is to distribute the earnings and profits of any corporation, then, notwithstanding paragraph (1) or (2), subsection (a) or (b) (as the case may be) shall apply to that portion of such distribution not attributable to such contribution to capital, and shall not apply to that portion of such distrubution attributable to such contribution to capital.

(e) FINAL CERTIFICATION.—

(1) FOR SUBSECTION (a).—Subsection (a) shall not apply with respect to any distribution by a corporation unless the Board certifies that, before the expiration of the period permitted under section 4(a) of the Bank Holding Company Act of 1956 (including any extensions thereof granted to such corporation under such section 4(a)), the corporation has disposed of all the property the disposition of which is necessary or appropriate to effectuate section 4 of such Act (or would have been so necessary or appropriate if the corporation had continued to be a bank holding company).

(2) FOR SUBSECTION (b).—

(A) Subsection (b) shall not apply with respect to any distribution by any corporation unless the Board certifies that, before the expiration of the period specified in subparagraph (B), the corporation has ceased to be a bank holding company.

(B) The period referred to in subparagraph (A) is the period which expires 2 years after the date of the enactment

of this part or 2 years after the date on which the corporation becomes a bank holding company, whichever date is later. The Board is authorized, on application by any corporation, to extend such period from time to time with respect to such corporation for not more than one year at a time if, in its judgment, such an extension would not be detrimental to the public interest; except that such period may not in any case be extended beyond the date 5 years after the date of the enactment of this part or 5 years after the date on which the corporation becomes a bank holding company, whichever date is later.

(f) CERTAIN EXCHANGES OF SECURITIES.—In the case of an exchange describe in subsection (a) (2) (A) (iv) or subsection (b) (2) (A) (iv), subsection (a) or subsection (b) (as the case may be) shall apply only to the extent that the principal amount of the securities received does not exceed the principal amount of the securities exchanged.

SEC. 1102. SPECIAL RULES.

(a) BASIS OF PROPERTY ACQUIRED IN DISTRIBUTIONS.—If, by reason of section 1101, gain is not recognized with respect to the receipt of any property, then, under regulations prescribed by the Secretary or his delegate—

(1) if the property is received by a shareholder with respect to stock, without the surrender by such shareholder of stock, the basis of the property received and of the stock with respect to which it is distributed shall, in the distributee's hands, be determined by allocating between such property and such stock the adjusted basis of such stock; or

(2) if the property is received by a shareholder in exchange for stock or by a security holder in exchange for securities, the basis of the property received shall, in the distributee's hands, be the same as the adjusted basis of the stock or securities exchanged, increased by—

(A) the amount of the property received which was treated as a dividend, and

(B) the amount of gain to the taxpayer recognized on the property received (not including any portion of such gain which was treated as a dividend).

(b) PERIODS OF LIMITATION.—The periods of limitation provided in section 6501 (relating to limitations on assessment and collection) shall not expire, with respect to any deficiency (including interest and additions to the tax) resulting solely from the receipt of property by shareholders in a distribution which is certified by the Board under subsection (a), (b), or (c) of section 1101, until five years after the distributing corporation notifies the Secretary or his delegate (in such manner and with such accompanying information as the Secretary or his delegate may by regulations prescribe) that the period (including extensions thereof) prescribed in section 4(a) of the Bank Holding Company Act of 1956, or section 1101(e)(2)(B), whichever is applicable, has expired; and such assessment may be made notwithstanding any provision of law or rule of law which would otherwise prevent such assessment.

(c) ALLOCATION OF EARNINGS AND PROFITS.—

(1) DISTRIBUTION OF STOCK IN A CONTROLLED CORPORATION.—In the case of a distribution by a qualified bank holding corporation under section 1101(a)(1) or (b)(1) of stock in a controlled corporation, proper allocation with respect to the earnings and profits of the distributing corporation and the controlled corporation shall be made under regulations prescribed by the Secretary or his delegate.

(2) EXCHANGES DESCRIBED IN SECTION 1101(C) (2) OR (3).—In the case of any exchange described in section 1101(c) (2) or (3), proper allocation with respect to the earnings and profits of the corporation transferring the property and the corporation receiving such property shall be made under regulations prescribed by the Secretary or his delegate.

(3) DEFINITIONS OF CONTROLLED CORPORATION.—For purposes of paragraph (1), the term "controlled corporation" means a corporation with respect to which at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock is owned by the distributing qualified bank holding corporation.

(d) ITEMIZATION OF PROPERTY.—In any certification under this part, the Board shall make such specification and itemization of property as may be necessary to carry out the provisions of this part.

(e) CERTAIN BANK HOLDING COMPANIES.—This part shall apply in respect of any company which becomes a bank holding company as a result of the enactment of the Act entitled "An Act to amend the Bank Holding Company Act of 1956", approved July 1, 1966 (Public Law 89–485), with the following modifications:

(1) Subsections (a)(3) and (b)(3) of section 1101 shall not apply.

(2) Subsections (a) (1) and (2) and (b) (1) and (2) of section 1101 shall apply in respect of distributions to shareholders of the distributing bank holding corporation only if all distributions to each class of shareholders which are made

(A) after April 12, 1965, and

(B) on or before the date on which the Board of Governors of the Federal Reserve System makes its final certification under section 1101(e),

are pro rata. For purposes of the preceding sentence, any redemption of stock made in whole or in part with property other than money shall be treated as a distribution.

(3) In applying subsections (c) and (d) of section 1101 and subsection (b) of section 1103, the date "April 12, 1965" shall be substituted for the date "May 15, 1955".

(4) In applying subsection (d)(3) of section 1101, the date of the enactment of this subsection shall be treated as being the date of the enactment of this part.

(5) In applying subsection (b)(2)(A) of section 1103, the reference to the Bank Holding Company Act of 1956 shall be treated as referring to such Act as amended by Public Law 89–485.

SEC. 1103. DEFINITIONS.

(a) BANK HOLDING COMPANY.—For purposes of this part, the term "bank holding company" has the meaning assigned to such term by section 2 of the Bank Holding Company Act of 1956.

(b) Qualified Bank Holding Corporation.—

(1) In general.—Except as provided in paragraph (2), for purposes of this part the term "qualified bank holding corporation" means any corporation (as defined in section 7701(a)(3)) which is a bank holding company and which holds prohibited property acquired by it—

(A) on or before May 15, 1955,

(B) in a distribution in which gain to such corporation with respect to the receipt of such property was not recognized by reason of subsection (a) or (b) of section 1101, or

(C) in exchange for all of its stock in an exchange described in section 1101 (c) (2) or (c) (3).

(2) Limitations.—

(A) A bank holding company shall not be a qualified bank holding corporation, unless it would have been a bank holding company on May 15, 1955, if the Bank Holding Company Act of 1956 had been in effect on such date, or unless it is a bank holding company determined solely by reference to—

(i) property acquired by it on or before May 15, 1955,

(ii) property acquired by it in a distribution in which gain to such corporation with respect to the receipt of such property was not recognized by reason of subsection (a) or (b) of section 1101, and

(iii) property acquired by it in exchange for all of its stock in an exchange described in section 1101 (c) (2) or (3).

(B) A bank holding company shall not be a qualified bank holding corporation by reason of property described in subparagraph (B) of paragraph (1) or clause (ii) of subparagraph (A) of this paragraph, unless such property was acquired in a distribution with respect to stock, which stock was acquired by such bank holding company—

(i) on or before May 15, 1955,

(ii) in a distribution (with respect to stock held by it on May 15, 1955, or with respect to stock in respect of which all previous applications of this clause are satisfied) with respect to which gain to it was not recognized by reason of subsection (a) or (b) of section 1101, or

(iii) in exchange for all of its stock in an exchange described in section 1101(c) (2) or (3).

(C) A corporation shall be treated as a qualified bank holding corporation only if the Board certifies that it satisfies the foregoing requirements of this subsection.

(c) Prohibited Property.—For purposes of this part, the term "prohibited property" means, in the case of any bank holding company, property (other than nonexempt property) the disposition of which would be necessary or appropriate to effectuate section 4 of the Bank Holding Company Act of 1956 if such company continued to be a bank holding company beyond the period (including any extensions thereof) specified in subsection (a) of such section or in section 1101(e)(2)(B) of this part, as the case may be. The term "prohibited property" does not include shares of any company held by a bank holding company to the extent that the prohibitions of section 4 of

the Bank Holding Company Act of 1956 do not apply to the ownership by such bank holding company of such property by reason of subsection (c)(5) of such section.

(d) NONEXEMPT PROPERTY.—For purposes of this part, the term "nonexempt property" means—

(1) obligations (including notes, drafts, bills of exchange, and bankers' acceptances) having a maturity at the time of issuance of not exceeding 24 months, exclusive of days of grace.

(2) securities issued by or guaranteed as to principal or interest by a government or subdivision thereof or by any instrumentality of a government or subdivision; or

(3) money, and the right to receive money not evidenced by a security or obligation (other than a security or obligation described in paragraph (1) or (2).

(e) BOARD.—For purposes of this part, the term "Board" means the Board of Governors of the Federal Reserve System.

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SEC. 2039. ANNUITIES.

(a) GENERAL.—The gross estate shall include the value of an annuity or other payment receivable by any beneficiary by reason of surviving the decedent under any form of contract or agreement entered into after March 3, 1931 (other than as insurance under policies on the life of the decedent), if, under such contract or agreement, an annuity or other payment was payable to the decedent, or the decedent possessed the right to receive such annuity or payment, either alone or in conjunction with another for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death.

(b) AMOUNT INCLUDIBLE.—Subsection (a) shall apply to only such part of the value of the annuity or other payment receivable under such contract or agreement as is proportionate to that part of the purchase price therefor contributed by the decedent. For purposes of this section, any contribution by the decedent's employer or former employer to the purchase price of such contract or agreement (whether or not to an employee's trust ,or fund forming part of a pension, annuity, retirement, bonus or profit-sharing plan) shall be considered to be contributed by the decedent if made by reason of his employment.

(c) EXEMPTION OF ANNUITIES UNDER CERTAIN TRUSTS AND PLANS.—Notwithstanding the provisions of this section or of any provision of law, there shall be excluded from the gross estate the value of an annuity or other payment receivable by any beneficiary (other than the executor) under—

(1) an employees' trust (or under a contract purchased by an employees' trust) forming part of a pension, stock bonus, or profit-sharing plan which, at the time of the decedent's separation from employment (whether by death or otherwise), or at the time of termination of the plan if earlier, met the requirements of section 401(a);

(2) a retirement annuity contract purchased by an employer (and not by an employees' trust) pursuant to a plan which, at the time of decedent's separation from employment (by death or otherwise), or at the time of termination of the plan if earlier, was a plan described in section 403(a);

(3) a retirement annuity contract purchased for an employee by an employer which is an organization referred to in section 503(b) (1), (2), or (3), and which is exempt from tax under section 501(a); or

(4) chapter 73 of title 10 of the United States Code.

If such amounts payable after the death of the decedent under a plan described in paragraph (1) or (2), under a contract described in paragraph (3), or under chapter 73 of title 10 of the United States Code are attributable to any extent to payments or contributions made by the decedent, no exclusion shall be allowed for that part of the value of such amounts in the proportion that the total payments or contributions made by the decedent bears to the total payments or contributions made. For purposes of this subsection, contributions or payments made by the decedent's employer or former employer under a trust or plan described in paragraph (1) or (2) shall not be considered to be contributed by the decedent, and contributions or payments made by the decedent's employer or former employer toward the purchase of an annuity contract described in paragraph (3) shall, to the extent excludable from gross income under section 403(b), not be considered to be contributed by the decedent. For purposes of this subsection, contributions or payments on behalf of the decedent while he was an employee within the meaning of section 401(c)(1) made under a trust or plan described in paragraph (1) or (2) shall be considered to be contributions or payments made by the decedent. For purposes of this subsection, amounts payable under chapter 73 of title 10 of the United States Code are attributable to payments or contributions made by the decedent only to the extent of amounts deposited by him pursuant to section 1438 of such title 10.

(d) Payments Under Certain Retirement Plans.—For purposes of subsection (c), a retirement plan described in section 101(b)(2)(E) of an employer described in subsection (c)(3) shall, under regulations prescribed by the Secretary or his delegate, by treated as a retirement annuity contract to which section 403(b) applied purchased by such employer.

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SEC. 2517. CERTAIN ANNUITIES UNDER QUALIFIED PLANS.

(a) General Rule.—The exercise or nonexercise by an employee of an election or option whereby an annuity or other payment will become payable to any beneficiary at or after the employee's death shall not be considered a transfer for purposes of this chapter if the option or election and annuity or other payment is provided for under—

(1) an employees' trust (or under a contract purchased by an employees' trust) forming part of a pension, stock bonus, or profit-sharing plan which, at the time of such exercise or nonexercise, or at the time of termination of the plan if earlier, met the requirements of section 401(a);

(2) a retirement annuity contract purchased by an employer (and not by an employees' trust) pursuant to a plan which, at the time of such exercise or nonexercise, or at the time of termination of the plan if earlier, was a plan described in section 403(a);

(3) a retirement annuity contract purchased for an employee by an employer which is an organization referred to in section 503(b) (1), (2), or (3), and which is exempt from tax under section 501(a); or

(4) chapter 73 of title 10 of the United States Code.

(*b*) TRANSFERS ATTRIBUTABLE TO EMPLOYEE CONTRIBUTIONS.—If the annuity or other payment referred to in subsection (a) (other than paragraph (4)) is attributable to any extent to payments or contributions made by the employee, then subsection (a) shall not apply to that part of the value of such annuity or other payment which bears the same proportion to the total value of the annuity or other payment as the total payments or contributions made by the employee bear to the total payments or contributions made. For purposes of the preceding sentence, payments or contributions made by the employee's employer or former employer toward the purchase of an annuity contract described in subsection (a)(3) shall, to the extent not excludable from gross income under section 403(b), be considered to have been made by the employee. For purposes of this subsection, payments on contributions on behalf of an individual while he was an employee within the meaning of section 401(c)(1) made under a trust or plan described in subsection (a)(1) or (2) shall be considered to be payments or contributions made by the employee.

(c) EMPLOYEE DEFINED.—For purposes of this section, the term "employee" includes a former employee.

(d) TRANSFERS UNDER CERTAIN RETIREMENT PLANS.—For purposes of subsections (a) and (b), a retirement plan described in section 101(b)(2)(E) of an employer described in subsection (a)(3) shall, under regulations prescribed by the Secretary or his delegate, be treated as a retirement annuity contract to which section 403(b) applies purchased by such employer.

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SEC. 6411. TENTATIVE CARRYBACK ADJUSTMENTS.

(a) APPLICATION FOR ADJUSTMENT.—A taxpayer may file an application for a tentative carryback adjustment of the tax for the prior taxable year affected by a net operating loss carryback provided in section 172(b), or by an investment credit carryback provided in section 46(b), from any taxable year. The application shall be verified in the manner prescribed by section 6065 in the case of a return of such taxpayer, and shall be filed, on or after the date of filing of the return for the taxable year of the net operating loss or unused investment credit from which the carryback results and within a period of 12 months from the end of such taxable year (*or, with respect to any portion of an investment credit carryback from a taxable year attributable to a net operating loss carryback from a subsequent taxable year, within a period of 12 months from the end of such subsequent taxable year*), in the manner and form required by regulations prescribed by the Secretary or his delegate. The application shall set forth in such detail and with such supporting data and explanation as such regulations shall require—

(1) The amount of the net operating loss or unused investment credit;

(2) The amount of the tax previously determined for the prior taxable year affected by such carryback, the tax previously determined being ascertained in accordance with the method prescribed in section 1314(a);

(3) The amount of decrease in such tax, attributable to such carryback, such decrease being determined by applying the carryback in the manner provided by law to the items on the basis of which such tax was determined;

(4) The unpaid amount of such tax, not including any amount required to be shown under paragraph (5);

(5) The amount, with respect to the tax for the taxable year immediately preceding the taxable year from which the carryback is made, as to which an extension of time for payment under section 6164 is in effect; and

(6) Such other information for purposes of carrying out the provisions of this section as may be required by such regulations.

An application under this subsection shall not constitute a claim for credit or refund.

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SEC. 6501. LIMITATIONS ON ASSESSMENT AND COLLECTION.

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(j) INVESTMENT CREDIT CARRYBACKS.—In the case of a deficiency attributable to the application to the taxpayer of an investment credit carryback (including deficiencies which may be assessed pursuant to the provisions of section 6213(b)(2)), such deficiency may be assessed at any time before the expiration of the period within which a deficiency for the taxable year of the unused investment credit which results in such carryback may be assessed, *or, with respect to any portion of an investment credit carryback from a taxable year attributable to a net operating loss carryback from a subsequent taxable year, at any time before the expiration of the period within which a deficiency for such subsequent taxable year may be assessed.*

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SEC. 6511. LIMITATIONS ON CREDIT OR REFUND.

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(d) SPECIAL RULES APPLICABLE TO INCOME TAXES.—

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(4) SPECIAL PERIOD OF LIMITATION WITH RESPECT TO INVESTMENT CREDIT CARRYBACKS.—

(A) PERIOD OF LIMITATION.—If the claim for credit or refund relates to an overpayment attributable to an investment credit carryback, in lieu of the 3-year period of limitation prescribed in subsection (a), the period shall be that period which ends with the expiration of the 15th day of the 40th month (or 39th month, in the case of a corporation) following the end of the taxable year of the unused investment credit which results in such carryback (*or, with respect to any portion of an investment credit carryback from a taxable year attributable to a net operating loss carryback from a subsequent taxable year, the period shall be that period which ends with the expiration of the 15th day of the 40th month, or 39th month, in the case of a corporation, following the end of such subsequent taxable year*), or the period prescribed in subsection (c) in respect of such taxable year, whichever expires later. In the case of such a claim, the amount of the credit or refund may exceed the portion of the tax paid within the period provided in subsection (b)(2) or (c), whichever is applicable, to the extent of the amount of the overpayment attributable to such carryback.

(B) APPLICABLE RULES.—If the allowance of a credit or refund of an overpayment of tax attributable to an invest-

ment credit carryback is otherwise prevented by the operation of any law or rule of law other than section 7122, relating to compromises, such credit or refund may be allowed or made, if claim therefor is filed within the period provided in subparagraph (A) of this paragraph. In the case of any such claim for credit or refund, the determination by any court, including the Tax Court, in any proceeding in which the decision of the court has become final, shall not be conclusive with respect to the investment credit, and the effect of such credit, to the extent that such credit is affected by a carryback which was not in issue in such proceeding.

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SEC. 6601. INTEREST ON UNDERPAYMENT, NONPAYMENT, OR EXTENSIONS OF TIME FOR PAYMENT, OF TAX.

(a) GENERAL RULE.—If any amount of tax imposed by this title (whether required to be shown on a return, or to be paid by stamp or by some other method) is not paid on or before the last date prescribed for payment, interest on such amount at the rate of 6 percent per annum shall be paid for the period from such last date to the date paid.

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(e) INCOME TAX REDUCED BY CARRYBACK OR ADJUSTMENT FOR CERTAIN UNUSED DEDUCTIONS—

(1) NET OPERATING LOSS CARRYBACK.—If the amount of any tax imposed by subtitle A is reduced by reason of a carryback of a net operating loss, such reduction in tax shall not affect the computation of interest under this section for the period ending with the last day of the taxable year in which the net operating loss arises.

(2) INVESTMENT CREDIT CARRYBACK.—If the credit allowed by section 38 for any taxable year is increased by reason of an investment credit carryback, such increase shall not affect the computation of interest under this section for the period ending with the last day of the taxable year in which the investment credit carryback arises, *or, with respect to any portion of an investment credit carryback from a taxable year attributable to a net operating loss carryback from a subsequent taxable year, such increase shall not affect the computation of interest under this section for the period ending with the last day of such subsequent taxable year.*

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SEC. 6611. INTEREST ON OVERPAYMENTS.

(a) RATE.—Interest shall be allowed and paid upon any overpayment in respect of any internal revenue tax at the rate of 6 percent per annum.

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(f) REFUND OF INCOME TAX CAUSED BY CARRYBACK OR ADJUSTMENT FOR CERTAIN UNUSED DEDUCTIONS.—

(1) NET OPERATING LOSS CARRYBACK.—For purposes of subsection (a), if any overpayment of tax imposed by subtitle A results from a carryback of a net operating loss, such overpayment shall be deemed not to have been made prior to the close of the taxable year in which such net operating loss arises.

(2) INVESTMENT CREDIT CARRYBACK.—For purposes of subsection (a), if any overpayment of tax imposed by subtitle A results from an investment credit carryback, such overpayment shall be deemed not to have been made prior to the close of the taxable year in which such investment credit carryback arises, *or, with respect to any portion of an investment credit carryback from a taxable year attributable to a net operating loss carryback from a subsequent taxable year, such overpayment shall be deemed not to have been made prior to the close of such subsequent taxable year.*

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SECOND LIBERTY BOND ACT

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SEC. 26. The Secretary of the Treasury is authorized to issue, from time to time, tax and loss bonds, the proceeds of which shall be available to meet any public expenditures authorized by law, and to retire any outstanding obligations of the United States issued under this Act. Tax and loss bonds shall be nontransferable except as provided by the Secretary of the Treasury, shall bear no interest and shall be issued in such amounts, subject to the limitations imposed by section 21 of this Act, as are necessary to permit persons to comply with section 832(e) of the Internal Revenue Code of 1954. Tax and loss bonds shall be issued in such amounts and on such terms and conditions as required by section 832(e) of such Code and as the Secretary of the Treasury shall prescribe. With respect to any taxable year in which amounts are subtracted from the mortgage guaranty account referred to in section 832(e)(3) of such Code, an amount of tax and loss bonds which was purchased under section 832(e)(2) of such Code with respect to the amount so subtracted shall be redeemed, and to the extent necessary shall be applied to pay any taxes due as a result of the inclusion under section 832(b)(1)(E) of such Code of amounts in gross income. In addition, tax and loss bonds may be redeemed as prescribed by the Secretary of the Treasury.