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LOSSES ON WORTHLESS STOCK

December 30 (legislative day, December 28), 1970.—Ordered to be printed

Mr. Long, from the Committee on Finance, submitted the following

REPORT

[To accompany H.R. 19369]

The Committee on Finance to which was referred the bill (H.R. 19369) to amend section 165(g) of the Internal Revenue Code of 1954 which provides for treatment of losses on worthless securities, having considered the same, reports favorably thereon without amendment and recommends that the bill do pass.

I. SUMMARY

H.R. 19369, in general, reduces from 95 percent to 80 percent the amount of stock a parent corporation must own in a subsidiary corporation in order to claim an ordinary loss deduction for the stock it holds in the subsidiary corporation if this stock becomes worthless. The same percentage ownership requirement presently applies where a parent corporation desires to file a consolidated income tax return with a subsidiary.

The Treasury Department has indicated that it does not oppose the enactment of this bill.

II. REASONS FOR BILL

Under present law, a corporation whose stock or securities in a subsidiary company become worthless is allowed an ordinary loss deduction, rather than the capital loss treatment generally provided for worthless securities. However, a company is considered a subsidiary company for this purpose only if the parent corporation owns at least 95 percent of each class of the subsidiary's stock. Despite this treatment under the worthless stock provision, in determining when a parent company may file a consolidated income tax return with its subsidiary, present law provides a substantially lower percentage ownership test. For this purpose, a company is considered a subsidiary company if the parent corporation owns 80 percent, rather than 95 percent, of the subsidiary's voting power and each class of the subsidiary's nonvoting stock.

When the ordinary loss treatment for securities of a subsidiary company which become worthless was originally enacted in 1942, Congress indicated it was providing this treatment since (at that time) a consolidated income tax return could be filed by a parent and its subsidiar companies where the parent had a 95-percent ownership interest in the subsidiaries. In these cases the concept was that the companies were considered closely enough related, in effect, to treat them as one operating business. In the case of consolidated return treatment, the losses of one may be offset against the income of the other. In the case where the securities of the subsidiary company become worthless, following the same concept, the loss, in effect, is regarded as a loss of part of the business of the parent corporation rather than as a loss on an investment.

The Internal Revenue Code of 1954 reduced the required ownership which must exist for companies to file consolidated returns from 95 percent to 80 percent. A similar change, however, was not made in the ownership requirement which applies in the case of the ordinary loss deduction allowed for worthless securities of a subsidiary company. Since an 80-percent control interest is considered an appropriate degree of relation for purposes of treating two or more corporations as one business under the consolidated return provisions of the tax law, the committee believes it also is appropriate to reduce the required ownership for ordinary loss treatment of worthless stock and securities of a subsidiary company from 95 percent to 80 percent. Accordingly, the bill generally conforms the ownership requirement under the worthless securities provision to that which applies in the case of consolidated returns.

III. EXPLANATION OF BILL

The bill amends the provision in the tax laws (sec. 165(g)(3)) allowing a corporation ordinary loss treatment for its holdings of stock or securities of a subsidairy company which become worthless, by substituting an 80-percent ownership requirement for the present 95-percent requirement. As a result, ordinary loss treatment is to be available to a parent company for its holdings of securities in a subsidiary which become worthless if the parent company directly owns at least 80 percent of the voting power of all classes of the subsidiary's stock and at least 80 percent of each class of the subsidiary's nonvoting stock. For purposes of this ownership test, nonvoting stock which is limited and preferred as to dividends is not taken into account.

The amendments made by this bill are to apply to taxable years beginning on or after January 1, 1970.

IV. CHANGES IN EXISTING LAW

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

SECTION 165(g) OF THE INTERNAL REVENUE CODE OF 1954

(g) WORTHLESS SECURITIES.—

(1) GENERAL RULE.—If any security which is a capital asset becomes worthless during the taxable year, the loss resulting therefrom shall, for purposes of this subtitle, be treated as a loss from the sale or exchange, on the last day of the taxable year, of a capital asset.

(2) SECURITY DEFINED.—For purposes of this subsection, the term "security" means—

(A) a share of stock in a corporation;

(B) a right to subscribe for, or to receive, a share of stock in a corporation; or

(C) a bond, debenture, note, or certificate, or other evidence of indebtedness, issued by a corporation or by a government or political subdivision thereof, with interest coupons or in registered form.

(3) SECURITIES IN AFFILIATED CORPORATION.—For purposes of paragraph (1), any security in a corporation affiliated with a taxpayer which is a domestic corporation shall not be treated as a capital asset. For purposes of the preceding sentence, a corporation shall be treated as affiliated with the taxpayer only if—

(A) [at least 95 percent of each class of its stock] *stock possessing at least 80 percent of the voting power of all classes of its stock and at least 80 percent of each class of its nonvoting stock* is owned directly by the taxpayer, and

(B) more than 90 percent of the aggregate of its gross receipts for all taxable years has been from sources other than royalties, rents (except rents derived from rental of properties to employees of the corporation in the ordinary course of its operating business), dividends, interest (except interest received on deferred purchase price of operating assets sold), annuities, and gains from sales or exchanges of stocks and securities.

In computing gross receipts for purposes of the preceding sentence, gross receipts from sales or exchanges of stocks and securities shall be taken into account only to the extent of gains therefrom. *As used in subparagraph (A), the term "stock" does not include nonvoting stock which is limited and preferred as to dividends.*

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