# MISCELLANEOUS TIMING REQUIREMENTS OF THE REVENUE LAWS

## HEARING

BEFORE THE

## SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT GENERALLY

OF THE

## COMMITTEE ON FINANCE

## UNITED STATES SENATE

NINETY-FIFTH CONGRESS

SECOND SESSION

ON

## H.R. 7320

AN ACT TO REVISE MISCELLANEOUS TIMING REQUIREMENTS OF THE REVENUE LAWS, AND FOR OTHER PURPOSES

MARCH 17, 1978

Printed for the use of the Committee on Finance

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# MISCELLANEOUS TIMING REQUIREMENTS OF THE REVENUE LAWS

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**FRIDAY, MARCH 17, 1978**

U.S. SENATE,
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
GENERALLY OF THE COMMITTEE ON FINANCE,
*Washington, D.C.*

The subcommittee met, pursuant to notice, at 2 p.m. in room 2221, Dirksen Senate Office Building, Hon. Harry F. Byrd, Jr. (chairman of the subcommittee) presiding.

Present: Senators Byrd and Hansen.

[The committee press release and the text of the bill, H.R. 7320, follow:]

[Press Release]

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT ANNOUNCES HEARING ON H.R. 7320

Subcommittee Chairman Harry F. Byrd, Jr. (I-Va.) and Senator Bob Packwood (R.-Oreg.), ranking Republican member, today announced that a hearing will be held on Friday, March 17, 1978, on H.R. 7320. The bill would revise various timing requirements under the Internal Revenue Code. This measure was originally introduced in the House of Representatives by Congressmen Al Ullman and Joe Waggonner.

The provisions contained in the bill are of general applicability and have been developed from a list of legislative recommendations submitted by the American Bar Association, the American Institute of Certified Public Accountants and other groups including State and local bar and accounting associations.

The hearing will begin at 2:00 P.M. in Room 2221 Dirksen Senate Office Building.

The bill contains eight separate proposed changes:

1. The bill would extend the period for payments to qualify as deductible expenses in certain cases where the payments are to be made to related taxpayers.
2. The bill would allow an increase in basis where gain is recognized by corporations making distributions of property.
3. The bill would provide a 60-day extension of the 12-month period for nonrecognition of gain in connection with certain liquidations where there is an involuntary conversion.
4. The bill would extend the period for making Subchapter S elections by small business corporations. This provision could affect some pending court cases.
5. The bill would conform the due dates for the filing of income tax returns and annual information returns in the case of organizations exempt from tax under section 501(a) of the Internal Revenue Code.
6. The bill would extend the definition of whether a taxpayer is a farmer or fisherman for purposes of making declarations of estimated tax.
7. The bill would adjust the period of limitations for credit or refund on certain carrybacks of losses and credits.
8. The bill would permit the posting of a bond to stay collection of a penalty imposed under section 6672 for the failure to collect or pay over certain Federal taxes.

No significant revenue gain or loss is anticipated under the provisions contained in H.R. 7320.

Witnesses who desire to testify at the hearing should submit a written request to Michael Stern, Staff Director, Committee on Finance, Room 2227, Dirksen Senate Office Building, Washington, D.C. 20510 by no later than the close of business on Wednesday, March 15, 1978.

*Legislative Reorganization Act.*—Senator Byrd stated that the Legislative Reorganization Act of 1946, as amended, requires all witnesses appearing before the Committees of Congress "to file in advance written statements of their proposed testimony, and to limit their oral presentations to brief summaries of their argument."

Witnesses scheduled to testify must comply with the following rules:

(1) A copy of the statement must be filed by the close of business two days before the day the witness is scheduled to testify.

(2) All witnesses must include with their written statement *a summary of the principal points included in the statement.*

(3) The written statements must be typed on letter-size paper (not legal size) and at least *75 copies* must be submitted by the close of business the day before the witness is scheduled to testify.

(4) *Witnesses are not to read their written statements* to the Committee, but are to confine their ten-minute oral presentations to a summary of the points included in the statement.

(5) Not more than 10 minutes will be allowed for oral presentation.

*Written testimony.*—Senator Byrd stated that the Subcommittee would be pleased to receive written testimony from those persons or organizations who wish to submit statements for the record. Statements submitted for inclusion in the record should be typewritten, not more than 25 double-spaced pages in length and mailed with five (5) copies by April 15, 1978, to Michael Stern, Staff Director, Committee on Finance, Room 2227, Dirksen Senate Office Building, Washington, D.C.

95TH CONGRESS
1ST SESSION

# H. R. 7320

IN THE SENATE OF THE UNITED STATES

NOVEMBER 3 (legislative day, NOVEMBER 1), 1977
Read twice and referred to the Committee on Finance

# AN ACT

To revise miscellaneous timing requirements of the revenue laws, and for other purposes.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

**SECTION 1. AMENDMENT OF 1954 CODE.**

Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1954.

**SEC. 2. PERIOD FOR PAYMENT TO QUALIFY FOR DEDUCTIBILITY OF CERTAIN EXPENSES PAID TO RELATED TAXPAYERS.**

(a) AMENDMENT OF SECTION 267.—Section 267 (relating to losses, expenses, and interest with respect to transactions between related taxpayers) is amended by adding at the end thereof the following new subsection:

"(e) RULE WHERE LAST DAY OF 2½ MONTH PERIOD FALLS ON SUNDAY, ETC.—For purposes of subsection (a)(2)—

"(1) where the last day of the 2½ month period falls on Saturday, Sunday, or a legal holiday, such last day shall be treated as falling on the next succeeding day which is not a Saturday, Sunday, or a legal holiday, and

"(2) the determination of what constitutes a legal holiday shall be made under section 7503 with respect to the payor's return of tax under this chapter for the preceding taxable year."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply with respect to payments made after the date of the enactment of this Act.

**SEC. 3. INCREASE IN BASIS FOR AMOUNT OF GAIN RECOGNIZED TO THE DISTRIBUTING CORPORATION.**

(a) AMOUNT DISTRIBUTED.—Clause (ii) of section

301 (b) (1) (B) (relating to amount distributed in the case of corporate distributees) is amended to read as follows:

"(ii) the adjusted basis (in the hands of the distributing corporation immediately before the distribution) of the other property received, increased in the amount of gain recognized to the distributing corporation on the distribution."

(b) BASIS.—Subparagraph (B) of section 301 (d) (2) (relating to basis in case of corporate distributees) is amended to read as follows:

"(B) the adjusted basis (in the hands of the distributing corporation immediately before the distribution) of such property, increased in the amount of gain recognized to the distributing corporation on the distribution."

(c) EFFECT ON EARNINGS AND PROFITS.—Paragraph (3) of section 312 (c) (relating to adjustments for liabilities, etc.) is amended to read as follows:

"(3) any gain recognized to the corporation on the distribution."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions made after the date of the enactment of this Act.

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**SEC. 4. 60-DAY EXTENSION OF 12-MONTH PERIOD UNDER SECTION 337 WHERE THERE IS INVOLUNTARY CONVERSION.**

(a) AMENDMENT OF SECTION 337.—Section 337 (relating to gain or loss on sales or exchanges in connection with certain liquidations) is amended by adding at the end thereof the following new subsection:

"(c) SPECIAL RULE FOR INVOLUNTARY CONVERSIONS.—If—

"(1) there is an involuntary conversion (within the meaning of section 1033) of property of a distributing corporation and there is a complete liquidation of such corporation which qualifies under subsection (a),

"(2) the disposition of the converted property (within the meaning of clause (ii) of section 1033(a)(2)(E)) occurs during the 60-day period which ends on the day before the first day of the 12-month period, and

"(3) such corporation elects the application of this subsection at such time and in such manner as the Secretary may by regulations prescribe,

then for purposes of this section such disposition shall be treated as a sale or exchange occurring within the 12-month period."

(b) EFFECTIVE DATE.—The amendment made by sub-

section (a) shall apply with respect to dispositions of the converted property (within the meaning of clause (ii) of section 1033(a)(2)(E) of the Internal Revenue Code of 1954) occurring after the date of the enactment of this Act in taxable years ending after such date.

**SEC. 5. EXTENSION OF PERIOD FOR MAKING SUBCHAPTER S ELECTIONS.**

(a) AMENDMENT OF SECTION 1372(c).—Subsection (c) of section 1372 (relating to where and how subchapter S election may be made) is amended to read as follows:

"(c) WHEN AND HOW MADE.—An election under subsection (a) may be made by a small business corporation for any taxable year—

"(1) at any time during the preceding taxable year, or

"(2) at any time during the first month of the taxable year (or in the case of a corporation which was not in existence before the taxable year, at any time during the first 75 days of the taxable year).

Such election shall be made in such manner as the Secretary shall prescribe by regulations."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to elections made more than 60 days after the date of the enactment of this Act for taxable years beginning more than 60 days after such date of enactment.

(c) RETROACTIVE APPLICATION OF "PRECEDING TAXABLE YEAR" AMENDMENT.—

(1) IN GENERAL.—If—

(A) a small business corporation has treated itself in its return as an electing small business corporation under subchapter S of chapter 1 of the Internal Revenue Code of 1954 for any taxable year beginning before the date 60 days after the date of the enactment of this Act (hereinafter in this subsection referred to as the "election year"),

(B) such treatment was pursuant to an election which such corporation made during the taxable year immediately preceding the election year and which, but for this subsection, would not be effective, and

(C) at such time and in such manner as the Secretary of the Treasury or his delegate may prescribe by regulations—

(i) such corporation makes an election under this paragraph, and

(ii) all persons (or their personal representatives) who were shareholders of such corporation at any time beginning with the first day of the election year and ending on the date of the making of such election consent to such elec-

tion, consent to the application of the amendment made by subsection (a), and consent to the application of paragraph (3) of this subsection, then paragraph (1) of the first sentence of section 1372(e) of such Code (as amended by subsection (a)) shall apply with respect to the taxable years referred to in paragraph (2) of this subsection.

(2) YEARS TO WHICH AMENDMENT APPLIES.—In the case of an election under paragraph (1) by any corporation, the taxable years referred to in this paragraph are—

(A) the election year,

(B) all subsequent taxable years of such corporation, and

(C) in the case of each person who was a shareholder of such corporation at any time during any taxable year described in subparagraph (A) or (B)—

(i) the first taxable year of such person ending with or within a taxable year described in subparagraph (A) or (B), and

(ii) all subsequent taxable years of such person.

(3) STATUTE OF LIMITATIONS FOR ASSESSMENT OF DEFICIENCY.—If the assessment of any deficiency in

income tax resulting from the filing of an election under paragraph (1) for a taxable year ending before the date of such filing would be prevented, but for the application of this paragraph, before the expiration of one year after the date of such filing by any law or rule of law, then such deficiency (to the extent attributable to such election) may be assessed at any time before the expiration of such one-year period notwithstanding any law or rule of law which would otherwise prevent such assessment.

**SEC. 6. TIME FOR FILING INCOME TAX RETURNS IN THE CASE OF ORGANIZATIONS EXEMPT FROM TAXATION UNDER SECTION 501(a).**

(a) AMENDMENT OF SECTION 6072.—Section 6072 (relating to time for filing income tax returns) is amended by adding at the end thereof the following new subsection:

"(e) ORGANIZATIONS EXEMPT FROM TAXATION UNDER SECTION 501(a).—In the case of an income tax return of an organization exempt from taxation under section 501(a) (other than an employees' trust described in section 401(a)), a return shall be filed on or before the 15th day of the 5th month following the close of the taxable year."

(b) EFFECTIVE DATE.—The amendment made by sub-

section (a) shall apply to returns for taxable years beginning after the date of the enactment of this Act.

**SEC. 7. PERIOD FOR DETERMINING WHETHER A TAXPAYER IS A FARMER OR FISHERMAN FOR PURPOSES OF THE ESTIMATED TAX.**

(a) AMENDMENT OF SECTION 6073 (b).—Subsection (b) of section 6073 (relating to time for filing declaration of estimated tax in case of farmers and fishermen) is amended to read as follows:

"(b) FARMERS OR FISHERMEN.—Declarations of estimated tax required by section 6015 from any individual—

"(1) whose estimated gross income from farming or fishing (including oyster farming) for the taxable year is at least two-thirds of the total estimated gross income from all sources for the taxable year, or

"(2) whose gross income from farming or fishing (including oyster farming) shown on the return of the individual for the preceding taxable year is at least two-thirds of the total gross income from all sources shown on such return,

may, in lieu of the time prescribed in subsection (a), be filed at any time on or before January 15 of the taxable year succeeding the taxable year."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to declarations of estimated tax for

taxable years beginning after the date of the enactment of this Act.

**SEC. 8. PERIOD OF LIMITATIONS FOR CREDIT OR REFUND WITH RESPECT TO CERTAIN CARRYBACKS.**

(a) NET OPERATING LOSS OR CAPITAL LOSS CARRYBACKS.—Subparagraph (A) of section 6511(d)(2) (relating to special period of limitation with respect to net operating loss or capital loss carrybacks) is amended by striking out "with the expiration of the 15th day of the 40th month (or the 39th month, in the case of a corporation) following the end of" and inserting in lieu thereof "3 years after the time prescribed by law for filing the return (including extensions thereof) for".

(b) INVESTMENT CREDIT AND OTHER CREDIT CARRYBACKS.—

(1) Paragraph (4) of section 6511(d) (relating to special period of limitation with respect to investment credit carrybacks) is amended to read as follows:

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

"(A) PERIOD OF LIMITATION.—If the claim for credit or refund relates to an overpayment attributable to a credit carryback, in lieu of the 3-year period of limitation prescribed in subsection (a), the period shall be that period which ends 3 years after

the time prescribed by law for filing the return (including extensions thereof) for the taxable year of the unused credit which results in such carryback (or, with respect to any portion of a credit carryback from a taxable year attributable to a net operating loss carryback, capital loss carryback, or other credit carryback from a subsequent taxable year, the period shall be that period which ends 3 years after the time prescribed by law for filing the return, including extensions thereof, for 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 a 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 sub-

paragraph (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 any credit, and the effect of such credit, to the extent that such credit is affected by a credit carryback which was not in issue in such proceeding.

"(C) CREDIT CARRYBACK DEFINED.—For purposes of this paragraph, the term 'credit carryback' means any investment credit carryback, work incentive program credit carryback, and new employee credit carryback."

(2) Subsection (d) of section 6511 is amended—

(A) by striking out paragraphs (7) and (9), and

(B) by redesignating paragraph (8) as paragraph (7).

(c) TECHNICAL AND CONFORMING AMENDMENTS.—

(1) AMENDMENTS OF SECTION 6501.—

(A) Subsection (j) of section 6501 (relating to investment credit carrybacks) is amended to read as follows:

"(j) CERTAIN CREDIT CARRYBACKS.—

"(1) IN GENERAL.—In the case of a deficiency

attributable to the application to the taxpayer of a credit carryback (including deficiencies which may be assessed pursuant to the provisions of section 6213 (b) (3)), 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 credit which results in such carryback may be assessed, or with respect to any portion of a credit carryback from a taxable year attributable to a net operating loss carryback, capital loss carryback, or other credit 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.

"(2) CREDIT CARRYBACK DEFINED.—For purposes of this subsection, the term 'credit carryback' has the meaning given such term by section 6511 (d) (4) (C)."

(B) Subsection (m) of section 6501 (relating to tentative carryback adjustment assessment period) is amended by striking out "subsection (h), (j), (o), or (p)" each place it appears and inserting in lieu thereof "subsection (h) or (j)".

(C) Section 6501 is amended by striking out subsections (o) and (p).

(2) AMENDMENTS OF SECTION 6601.—

(A) Paragraph (2) of section 6601 (d) (re-

lating to investment credit carryback) is amended to read as follows:

"(2) CERTAIN CREDIT CARRYBACKS.—

"(A) IN GENERAL.—If any credit allowed for any taxable year is increased by reason of a 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 credit carryback arises, or, with respect to any portion of a credit carryback from a taxable year attributable to a net operating loss carryback, capital loss carryback, or other credit 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.

"(B) CREDIT CARRYBACK DEFINED.—For purposes of this paragraph, the term 'credit carryback' has the meaning given such term by section 6511(d)(4)(C)."

(B) Subsection (d) of section 6601 is amended by striking out paragraphs (4) and (5).

(3) AMENDMENTS OF SECTION 6611.—

(A) Paragraph (3) of section 6611(f) (re-

lating to investment credit carryback) is amended to read as follows:

"(2) CERTAIN CREDIT CARRYBACKS.—

"(A) IN GENERAL.—For purposes of subsection (a), if any overpayment of tax imposed by subtitle A results from a credit carryback, such overpayment shall be deemed not to have been made before the close of the taxable year in which such credit carryback arises, or, with respect to any portion of a credit carryback from a taxable year attributable to a net operating loss carryback, capital loss carryback, or other credit carryback from a subsequent taxable year, such overpayment shall be deemed not to have been made before the close of such subsequent taxable year.

"(B) CREDIT CARRYBACK DEFINED.—For purposes of this paragraph, the term 'credit carryback' has the meaning given such term by section 6511(d)(4)(C)."

(B) Subsection (f) of section 6611 is amended by striking out paragraphs (4) and (5).

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to carrybacks arising in taxable years beginning after the date of the enactment of this Act.

**SEC. 9. STAY OF COLLECTION OF PENALTY UNDER SECTION 6672 WHERE BOND IS FILED.**

(a) IN GENERAL.—Section 6672 (relating to failure to collect and pay over tax, or attempt to evade or defeat tax) is amended by striking out "Any person" and inserting in lieu thereof "(a) GENERAL RULE.—Any person" and by adding at the end thereof the following new subsection:

"(b) EXTENSION OF PERIOD OF COLLECTION WHERE BOND IS FILED.—

"(1) IN GENERAL.—If, within 30 days after the day on which notice and demand of any penalty under subsection (a) is made against any person, such person—

"(A) pays an amount which is not less than the minimum amount required to commence a proceeding in court with respect to his liability for such penalty,

"(B) files a claim for refund of the amount so paid, and

"(C) furnishes a bond which meets the requirements of paragraph (3),

no levy or proceeding in court for the collection of the remainder of such penalty shall be made, begun, or prosecuted until a final resolution of a proceeding begun as provided in paragraph (2). Notwithstanding the provisions of section 7421 (a), the beginning of such pro-

ceeding or levy during the time such prohibition is in force may be enjoined by a proceeding in the proper court.

"(2) SUIT MUST BE BROUGHT TO DETERMINE LIABILITY FOR PENALTY.—If, within 30 days after the day on which his claim for refund with respect to any penalty under subsection (a) is denied, the person described in paragraph (1) fails to begin a proceeding in the appropriate United States district court (or in the Court of Claims) for the determination of his liability for such penalty, paragraph (1) shall cease to apply with respect to such penalty, effective on the day following the close of the 30-day period referred to in this paragraph.

"(3) BOND.—The bond referred to in paragraph (1) shall be in such form and with such sureties as the Secretary may by regulations prescribe and shall be in an amount equal to 1½ times the amount of excess of the penalty assessed over the payment described in paragraph (1).

"(4) SUSPENSION OF RUNNING OF PERIOD OF LIMITATIONS ON COLLECTION.—The running of the period of limitations provided in section 6502 on the collection by levy or by a proceeding in court in respect of any penalty described in paragraph (1) shall be

suspended for the period during which the Secretary is prohibited from collecting by levy or a proceeding in court.

"(5) JEOPARDY COLLECTION.—If the Secretary makes a finding that the collection of the penalty is in jeopardy, nothing in this subsection shall prevent the immediate collection of such penalty."

(b) TECHNICAL AMENDMENTS.—

(1) Subsection (a) of section 7421 is amended by inserting "6672(b), 6694(c)," after "6213(a),".

(2) Subsection (a) of section 7103 is amended by inserting after paragraph (3) the following new paragraph:

**"(4) For a bond to stay collection of a penalty assessed under section 6672, see section 6672(b)."**

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to penalties assessed more than 60 days after the date of the enactment of this Act.

Passed the House of Representatives November 1, 1977.

Attest: EDMUND L. HENSHAW, JR.,

*Clerk.*

Senator BYRD. The committee will come to order. The proceedings will proceed expeditiously. Each witness will be limited to 7 minutes, but the full statement of each witness will be inserted in the record.

The subcommittee will, today, consider H.R. 7320. This bill was introduced in the House of Representatives by Congressman Ullman and Congressman Waggonner and has passed the House of Representatives. It would revise the timing and filing requirements in various sections of the Internal Revenue Code.

The provisions affected by H.R. 7320 are described in a press release and a pamphlet published by the Finance Committee for these hearings. This information will be made a part of the record.

This measure was developed from suggestions provided by the American Bar Association, the American Institute of Certified Public Accountants and other professional tax organizations. No significant revenue gain or loss is anticipated under this measure.

Finally, I might add, that scheduling this bill on March 17, St. Patrick's Day, is highly significant for its future progress. Not only will it have the support of the American Bar Association, the American Institute of Certified Public Accountants, but it also is likely to have a little bit of the luck of the Irish.

Our first witness today—I do not know whether he is Irish or not, but he is Mr. John M. Samuels, Deputy Tax Legislative Counsel, Department of the Treasury. Welcome, Mr. Samuels.

Are you Irish?

Mr. SAMUELS. No, sir, I am not that fortunate today.

Senator BYRD. You do not even have a green tie on. You have a red tie on.

Mr. SAMUELS. Well, it is not orange.

Senator BYRD. Very good. You may proceed as you wish, Mr. Samuels.

Mr. SAMUELS. Thank you very much, Mr. Chairman. With me today is Benjamin J. Cohen of our staff, the Tax Legislative Counsel's Office.

## STATEMENT OF JOHN M. SAMUELS, DEPUTY TAX LEGISLATIVE COUNSEL, DEPARTMENT OF THE TREASURY, ACCOMPANIED BY BENJAMIN J. COHEN, STAFF, TAX LEGISLATIVE COUNSEL'S OFFICE

Mr. SAMUELS. We welcome the opportunity to present the Treasury's views on H.R. 7320. Because of the complexity of the tax laws, it is extremely important that a high priority be given to correcting technical statutory problems of general concern.

Section 6 of the bill is a representative provision. Charitable organizations, labor unions, employee benefit trusts, and other tax exempt organizations may be required to file two different returns with the Internal Revenue Service at two different times each year.

For example, a charitable organization might be required to file an income tax return on unrelated business income by March 15 and an information return by May 15.

Section 6 of the bill will generally permit both returns to be filed at the same time.

For example, the charitable organization just described would be permitted to file both returns on May 15.

The other provisions in the bill are similar. They also correct technical problems, some as simple as the one just described and others somewhat more complicated.

The Treasury appreciates the opportunity that it has been given to comment on H.R. 7320. We hope this bill represents only the beginning of a continuing effort to correct noncontroversial technical problems with the Internal Revenue Code. We offer our support in this effort and look forward to working with the chairman on future bills.

In the near future, we hope to present recommendations of our own for correcting additional technical problems of general concern.

In conclusion, Treasury supports H.R. 7320 and we would be glad to answer any questions that you may have regarding its provisions.

Senator BYRD. Thank you, Mr. Samuels.

As I understand it, the passage of this legislation would have no appreciable effect on revenues one way or the other?

Mr. SAMUELS. Yes, sir, that is the position of the Treasury. That is correct.

Senator BYRD. Could you give some of the examples of the unfair results under current law which would be changed by the proposals in H.R. 7320?

Mr. SAMUELS. Well, section 7, I think, of H.R. 7320 is a good example. Under present law, most taxpayers who are not subject to withholding are required to make quarterly payments of estimated income tax.

However, special rules apply to farmers or fishermen. Under these special rules, a farmer or fisherman is not required to make quarterly payments of estimated tax. Instead, he is permitted to make a single payment on January 15 for the year that has just ended. For this purpose, an individual is considered to be a farmer or fisherman if he derives two-thirds of his gross income from farming or fishing.

Now, in certain cases, this provision does not work well. For example, a person whom we would all consider to be a farmer might, as the result of a crop loss, not have two-thirds of his income from farming. What H.R. 7320 would do would be to enable that person to rely on his income from the prior year, the immediately preceding year, and if two-thirds of that income were from farming, he would still be able to file and pay his tax on January 15 of the following year without paying any penalties.

Senator BYRD. I think that is very important that that be recognized because farmers, of course, are dependent on the weather and many other obstacles, and it may be that many of them will lose money 1, 2, or 3 years in a row.

Mr. SAMUELS. And they certainly may not know when the time comes around for making payment of estimated tax whether or not they are going to have two-thirds of their gross income from farming for that year.

Senator BYRD. My observation has been that it is almost impossible in many farming endeavors to estimate farming income at the beginning of the year. The estimated tax would have to be filed by what, April 15, would it not?

Mr. SAMUELS. Yes, sir.

Senator BYRD. Weather conditions might be ideal up to that point, but it could change very rapidly, or very quickly, after that. So I think it is a very good point which you make.

Mr. SAMUELS. I think the same is equally true of fishermen.

Senator BYRD. Yes, the same with fishermen.

Thank you very much.

Mr. SAMUELS. Thank you.

[The prepared statement of Mr. Samuels follows:]

STATEMENT OF JOHN M. SAMUELS, DEPUTY TAX LEGISLATIVE COUNSEL

Mr. Chairman and Members of the Subcommittee: We welcome the opportunity to present the Treasury's views on H.R. 7320. Because of the complexity of the tax laws, it is extremely important that a high priority be given to correcting technical statutory problems of general concern.

The provisions of H.R. 7320 were developed from a list of recommendations made by the American Bar Association, the American Institute of Certified Public Accountants, and other groups in the professional tax community. We welcome the efforts of these groups and expect that they will continue to make recommendations of this kind for improvement of our tax laws.

Section 6 of the bill is a representative provision. Charitable organizations, labor unions, employee benefit trusts, and other tax exempt organizations may be required to file two different returns with the Internal Revenue Service at two different times each year. For example, a charitable organization might be required to file an income tax return on unrelated business income by March 15, and an information return by May 15. Section 6 of the bill will generally permit both returns to be filed at the same time. For example, the charitable organization just described would be permitted to file both returns on May 15.

Another representative provision is section 7. Under present law, many taxpayers whose income is not subject to withholding are required to make quarterly payments of estimated income tax. However, special rules apply to farmers and fishermen. Under these special rules, a farmer or fisherman is not required to make quarterly payments of estimated tax. Instead, he is permitted to make a single payment on January 15 for the year that has just ended. For this purpose, an individual is considered a farmer or fisherman if he derives two thirds of his gross income from farming or fishing. In certain cases, this two-thirds test does not work well; a person whom we would all consider a farmer or fisherman may not always be able to satisfy the test. For example, a crop failure might prevent a farmer from satisfying the two-thirds test. Section 7 of the bill would liberalize the definition of a farmer or fisherman. A farmer or fisherman would be allowed to satisfy the two-thirds test either in the year in question or in the first preceding year.

The other provisions in the bill are similar. They also correct technical problems, some as simple as the two just described, and others somewhat more complicated.

One last provision merits special mention. This is section 5 of the bill, which extends the period for making Subchapter S elections. Subchapter S allows certain small corporations to elect to be taxed in a manner similar to partnerships. The President's 1978 Tax Reform Program contains several proposals to simplify and liberalize Subchapter S. One of the President's proposals is very similar to Section 5 of the bill. There are only two differences. One difference is that the President's proposal is slightly more liberal. The other difference is that section 5 is retroactive, but the President's proposal is prospective only. Despite these differences, we do not oppose section 5 of the bill.

The Treasury appreciates the opportunity it has been given to comment on H.R. 7320. We hope this bill represents only the beginning of a continuing effort to correct noncontroversial technical problems with the Internal Revenue Code. We offer our support in this effort and look forward to working with the Chairman on future bills. In the near future, we hope to present recommendations of our own for correcting additional technical problems of general concern.

In conclusion, the Treasury supports H.R. 7320 and we would be glad to answer any questions you may have concerning its provisions.

Senator BYRD. The next witness is Mr. Arthur J. Dixon, chairman, Federal Tax Division, American Institute of Certified Public Accountants.

Welcome, Mr. Dixon.

Mr. DIXON. Thank you, Senator. It is a pleasure to be here today.

Senator BYRD. We are glad to have you.

I might say, as one who has operated a business for many years, I have often said that I would not be willing to be the chief executive officer of a business unless I had a good outside certified public accountant to come in each year and take a close look at the books. But I also tell my certified public accountant that just because I say that does not mean I give him a blank check in the billing sense.

Mr. DIXON. Well, that is a message we get very quickly.

## STATEMENT OF ARTHUR J. DIXON, CHAIRMAN, FEDERAL TAX DIVISION, AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Mr. DIXON. My name is Arthur J. Dixon and I am appearing today as the chairman of the Federal Tax Division of the American Institute of Certified Public Accountants. I am also the managing partner of the CPA firm of Oppenheim, Appel, Dixon & Co.

I am happy to testify in support of H.R. 7320, a bill which proposes certain amendments to the Internal Revenue Code relating primarily to timing requirements. The substance of its specific provisions is consistent with recommendations which the AICPA has made for several years, and I am pleased that the subcommittee is now considering these changes.

My statement, which we will file in full with you, sir, contains comments with respect to two provisions of the bill that we think should be considered, and I do not believe that it would be necessary for me to repeat them here.

As the representatives of two of the major professional groups which work with the tax law, both the Federal Tax Division of the AICPA and the section on taxation of the American Bar Association have devoted a great deal of time and attention to the improvement of the Internal Revenue Code. Our goals to that end are the same, and many of our legislative recommendations are quite similar. We do enjoy working with the ABA and with other professional organizations and with Congress, of course, in achieving these ends. We believe that the contents of H.R. 7320 qualify as technical, noncontroversial amendments to the code.

The AICPA takes considerable pride in its tax law recommendations. Our work in this area is motivated by a sincere desire to serve the public. The institute's full list of recommendations for change in the Internal Revenue Code are contained in our biannual publication, "Recommended Tax Law Changes," [1] a copy of which has previously been sent to the office of each member of the subcommittee. Many of the proposals contained in H.R. 7320 were drawn from this publication and I commend it to your attention.

I thank the subcommittee for its consideration of this bill and look forward to working with the subcommittee on future bills containing

[1] The publication was made a part of the committee file.

our recommendations. I appreciate the opportunity to appear before you today in support of H.R. 7320 and I urge approval of the bill by the Senate.

Senator BYRD. Thank you, Mr. Dixon.

How long did the professional group study these problems before making recommendations to the Congress?

Mr. DIXON. Well, a number of the provisions that are contained in this bill, Senator, were included in our legislative recommendations for some years. In due course, comparisons were made of our recommendations to those of the ABA, with a view to introducing this bill. We certainly do think this procedure is constructive, and we hope that other bills will be introduced that include other legislative recommendations we have made.

Senator BYRD. Thank you, sir.

I note that my able colleague and dear friend from Wyoming, Senator Hansen, has just come in. Senator Hansen, may I yield to you now?

Senator HANSEN. Thank you, Mr. Chairman. I am sorry to be late. I am keenly interested in the subject of these hearings and I will look forward to reading that testimony that is given. I have no questions.

Senator BYRD. Thank you, sir.

Thank you, Mr. Dixon.

Mr. DIXON. Thank you, Senator.

[The prepared statement of Mr. Dixon follows:]

STATEMENT OF ARTHUR J. DIXON, CHAIRMAN, FEDERAL TAX DIVISION, THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

My name is Arthur J. Dixon, and I am appearing today as the Chairman of the Federal Tax Division of the American Institute of Certified Public Accountants. I am also the Managing Partner of Oppenheim, Appel, Dixon & Co., a CPA firm.

I am happy to testify in support of H.R. 7320, a bill which proposes certain amendments to the Internal Revenue Code relating primarily to timing requirements. The substance of its specific provisions is consistent with recommendations which the AICPA has made for several years, and I am pleased that the Subcommittee is now considering these changes.

I would like to bring to the attention of the Subcommittee two issues which are related to this bill which have come to my attention since the hearings before the House Committee on Ways and Means.

Section 9 of the bill would permit the posting of a bond to stay collection of a penalty imposed under Section 6672 of the Code for failure to collect or pay over certain Federal taxes. Our proposal in this area was to allow the responsible officer to post bond in lieu of paying the taxes so that he or she could avoid a possible heavy cash outflow in order to have a day in court. However, I understand that in some cases the Internal Revenue Service is not requiring full payment of the taxes in order to go to court. For instance, where the issue involves many employees, the Service has permitted the responsible officer to pay the tax with respect to one employee and litigate the issue in such a way as to be binding for all employees when a decision is reached. The AICPA would certainly not wish to discourage this type of alternative solution to the problem. Our proposal was intended to create *a* solution to this problem rather than *the only* solution. I hope that the legislative history of H.R. 7320 will make it clear that the posting of bond would be available in all cases, that the posting of bond would not be mandatory, and that the enactment of Section 9 was not intended to discourage other possible solutions such as the one I have just mentioned.

The other issue is related to Section 5 of the bill, which extends the period for making a subchapter S election. Prior to The Tax Reform Act of 1976, an election of subchapter S status would be involuntarily terminated if any new shareholder of the corporation did not affirmatively consent to the election, generally within a period of 30 days from the day he or she became a shareholder. In 1976, Congress became concerned that the requirement of a new shareholder's affirmative consent

to a subchapter S election within a limited period of time could result in an inadvertent termination of the election if the new shareholder failed to file a timely consent or was not aware of the necessity of filing a consent. A termination of subchapter S status in these circumstances would cause a severe hardship not only to the new shareholder, but also to all of the other shareholders of the corporation. Therefore, Congress provided in The Tax Reform Act of 1976 that in order for a subchapter S election to be terminated, a new shareholder must affirmatively refuse to consent to the election within 60 days from the time he acquired his stock in the corporation in order to terminate the election.

Section 1372(a) of the Code still requires the consent of all shareholders on the first day of the first taxable year for which a subchapter S election is effective. Section 5 of H.R. 7320 extends the period for making a subchapter S election to any time during the year preceding the year for which the election is to become effective. However, under this change, the risk of an inadvertent termination would continue to be a significant problem. For example, if an election is filed early in a year to take effect for the next year, the consents would have to be obtained from any individuals who buy stock after the election is filed and before the second day of the taxable year for which the election is effective. The same trap for the unwary then exists as was sought to be remedied by The Tax Reform Act of 1976.

The AICPA therefore recommends that in connection with the change made by Section 5 of H.R. 7320, Section 1372(a) of the Code be revised to require the consent of the persons who are shareholders at the time the election is filed (rather than on the first day of the next taxable year). Conforming changes should be made under Code Section 1372(e)(1) to permit these new shareholders to affirmatively refuse to consent to the election in the same manner as for persons who become shareholders after the first day of the taxable year for which the election is effective.

As the representatives of two of the major professional groups which work with the tax law, both the Federal Tax Division of the AICPA and the Section of Taxation of the American Bar Association have devoted a great deal of time and attention to the improvement of the Internal Revenue Code. Our goals to that end are the same, and many of our legislative recommendations are quite similar. We believe that the contents of H.R. 7320 qualify as technical, noncontroversial amendments to the Code.

The AICPA takes considerable pride in its tax law recommendations. Our work in this area is motivated by a sincere desire to serve the public. The Institute's full list of recommendations for changes in the Internal Revenue Code are contained in our biennial publication, *Recommended Tax Law Changes*, a copy of which has previously been sent to the office of each member of the Subcommittee. Many of the proposals contained in H.R. 7320 were drawn from this publication, and I commend it to your attention.

I thank the Subcommittee for its consideration of this bill and look forward to working with the Subcommittee on future bills containing our recommendations. I appreciate the opportunity to appear before you today in support of H.R. 7320, and I urge approval of the bill by the Senate.

Senator BYRD. The next witness is Mr. John Pennell, chairman, section of taxation, American Bar Association.

Welcome, Mr. Pennell. We are delighted to have you with us today.

Mr. PENNELL. Thank you, Senator.

## STATEMENT OF JOHN PENNELL, CHAIRMAN, SECTION OF TAXATION, AMERICAN BAR ASSOCIATION

Mr. PENNELL. I appreciate the opportunity of being here and testifying on H.R. 7320. As has been indicated, H.R. 7320 is the first step in what we hope is an important new process to correct technical deficiencies in the Internal Revenue Code that inevitably creep into something as complex or comprehensive as the Internal Revenue Code.

The American Bar Association, through its section on taxation and the AICPA and other professional groups continually study the code

for areas where we believe improvement is proper and make suggestions to this effect which serve to correct the occasional oversights or inconsistencies that are inevitable.

H.R. 7320 is devoted, for the most part, to timing requirements in the code that need technical improvements. The American Bar Association wholeheartedly supports all of the provisions of this bill, but we do have suggestions for improvements for two of those provisions.

Section 4 of the bill adopts, in part, a recommendation of the American Bar Association that would make it possible to utilize section 337 of the code in a complete liquidation of the corporation following an involuntary conversion of its property such as destruction by fire.

Section 4 would allow the plan of liquidation to be adopted within 60 days after the involuntary conversion, overcoming the impossibility of adopting such a plan under existing law, section 337, before the involuntary conversion which constitutes the sale or exchange actually occurs.

Obviously it is difficult to plan for a fire or a flood and corporate officers cannot adopt a plan of liquidation before that involuntary conversion.

Section 4, however, does not include the balance of the association's recommendation which would permit the proceeds of the involuntary conversion to be distributed within 60 days after receipt of those proceeds.

Under section 337, the proceeds of the sale or exchange must be distributed within 1 year after the adoption of a plan of complete liquidation. Ordinarily, this is feasible, but in the case of an involuntary conversion, receipt of the insurance proceeds or the condemnation award frequently is delayed beyond this 1-year period.

The insurance adjustment process or the difficulty of establishing just compensation following a condemnation often requiring litigation in either case, often delays the receipt of the proceeds under circumstances which the corporation cannot avoid.

Frequently, it is not feasible to utilize a liquidating trust for shareholders in many of these cases. Such a trust may be held to be an association treated as a corporation under the code, resulting in loss of the benefits of section 337. Where there is a large number of shareholders, it is generally not feasible, and is feasible only to continue to use the existing corporate form because of transfers of shareholder interests and because of various legal uncertainties.

No tax avoidance would occur under the association's recommendation. That recommendation would provide that the proceeds must be distributed within 60 days after receipt of the proceeds. If the proceeds are freely available to the corporation but are not collected, the doctrine of constructive receipt would start the running of the 60-day period.

All other assets of the corporation will still be required to be distributed within the 12-month period after the adoption of the plan. We strongly recommend that section 4 of H.R. 7320 be expanded to include the provision permitting distribution of the proceeds of an involuntary conversion within 60 days after receipt, even if this extends beyond the normal 1-year period for the distribution and complete liquidation under section 337.

Turning to section 5, that section would permit an election of subchapter S status for small business corporations to be made at any time during the taxable year of the corporation preceding the year for which the election is to become effective.

In the case of new corporations, the provision would permit election to be made at any time within the first 75 days of the first taxable year. This would substantially liberalize existing law and prevent some of the very harsh results that have occurred to small businesses in this respect.

We strongly support it.

That section is based on a recommendation of the American Bar Association which would have gone somewhat further by permitting an existing small business corporation to make its subchapter S selection at any time within the preceding taxable year or the first 75 days of the taxable year for the year of election.

Thus, an existing corporation, as well as a new corporation, would be given 75 days within which to make the election for the first year this would become effective. We urge that the committee expand section 5 of H.R. 7320 to this limited degree so that the 75-day period would be available to existing corporations as well as new corporations.

It is frequently very difficult for corporate officers to decide whether a subchapter S election should be made until financial data for the preceding year has been accumulated and reviewed. This sometimes is not feasible within the 30-day period for election by existing law.

Often the small business corporation must rely on an outside accountant for these data. Many small business corporations use the calendar year as their taxable year and accountants are already greatly overburdened in the first month of the calendar year.

If the period were 75 days, this problem would be greatly relieved.

This provision would not result in tax avoidance. Corporate officers would still be required to act well before the pattern of operations for the entire current year would be known so there would be no opportunity for manipulation.

Present law provides that the shareholders who must consent are the persons who were the shareholders on the first day of the taxable year for which the election is to be effective, if the election is made before such effective date, or the persons who were shareholders on the date of the election, if the election is made after such effective date.

This also creates a trap for the unwary and one which could be magnified by the change in H.R. 7320 proposed by section 5.

If the election is made at any time during the preceding year and there is a change in stock ownership before the first day of the taxable year for which it is effective, the subchapter S shareholders may very well overlook the fact that they must obtain the new consent of the new shareholders.

Ordinarily, it is not necessary to obtain the consent of a new shareholder of a subchapter S corporation where an election is already in effect.

As a matter of substance, it makes more sense to provide that it should be the shareholders on the date of actual election who must give the consent. This is more consistent with section 1372(e) of present law which provides a new shareholder must affirmatively refuse to consent or to disaffirm an existing election.

This problem can easily be resolved by amending sections 1372 (a) and (e) to provide that the shareholders of the subchapter S corporation who must consent to the election are the shareholders on the date the election is made, whether it is made before or after the beginning of the first taxable year for which it is to be effective.

If the election is made before such elective date, any person who becomes a new shareholder before that effective date may affirmatively disaffirm and refuse to consent, as provided in section 1372(e)(1) and thereby terminate. This adequately would protect the new shareholder and this change would put the corporation that obtains a new shareholder following the date of its election, but before the effective date on the same footing as a corporation that currently has made the election and acquires a new shareholder.

Generally, in other respects, Mr. Chairman, we support H.R. 7320. It is an excellent bill. It contains important technical improvements in the code which are both necessary and entirely noncontroversial.

We strongly recommend that the Senate Finance Committee favorably report the bill to the Senate as soon as possible.

Senator BYRD. What you say seems logical to me.

Am I correct in my thinking that you are suggesting two amendments to H.R. 7320 as passed by the House?

Mr. PENNELL. Yes, Mr. Chairman.

Senator BYRD. Two amendments.

Mr. PENNELL. Two amendments.

Senator BYRD. May I ask Treasury's comments on those two amendments?

Mr. SAMUELS. I think, Mr. Chairman, that Treasury would generally be opposed to the first amendment without insuring that there would be no revenue loss entailed. As I understand it, under section 337, there is no gain at the corporate level when assets are sold, provided all of the assets are distributed to the shareholders within 12 months. When those assets are distributed to the shareholders, a tax is paid at the shareholder level.

I believe, if I correctly understand the proposal offered by the American Bar Association, if a claim against an insurance company had not been liquidated, that claim would not have to be distributed to the shareholders and therefore, gain would not be recognized within the 12-month period. It would, I think, be possible, at least in closely held corporations, for shareholders to not vigorously pursue the claim against the insurance company, thereby not being in constructive receipt of the cash and deferring the time at which the gain would be recognized at the shareholder level.

So I think we would want to carefully study that proposal before we were able to support it.

As to the proposal on subchapter S, I believe the Treasury would generally support the American Bar Association's proposed amendments. First, I think there are at least two aspects in which it was proposed to amend section 5 of the bill. The first would be to allow 75 days after the beginning of the taxable year during which an existing corporation could elect to be treated as a subchapter S corporation.

The President's tax reform proposals have substantially liberalized subchapter S and those proposals include an amendment that would allow shareholders of an existing corporation to elect subchapter S

within 60 days after the beginning of the taxable year. The American Bar Association's proposed amendment would extend that by 15 days. I think we would generally support that proposed amendment.

We similarly would support the second amendment which would avoid a trap for the unwary and make the date of the actual subchapter S election be determinative as to which shareholders have to consent.

Senator BYRD. So you would support the amendments dealing with subchapter S?

Mr. SAMUELS. Yes.

Senator BYRD. And you would reserve judgment on the first amendment?

Mr. SAMUELS. Yes; we do, but I would like to note that we do see potential for deferring the recognition of gain at the shareholder level and I think we would be concerned about the first amendment without further study.

Senator BYRD. I do not know just when the Finance Committee would be prepared to act on H.R. 7320, but could Treasury have a firmer recommendation, one way or the other, by that time?

Mr. SAMUELS. Yes, Mr. Chairman. We certainly can.

Senator BYRD. In regard to the subchapter S, one complaint that I have gotten from a number of people is that if one of the participants is a trusteeship for one individual, that, as I understand it, that would eliminate the use of subchapter S under the present law, would it not?

Suppose there were three people involved in a subchapter S corporation, two as individuals and one individual as a trustee for another individual. Under the present law, such a situation would disqualify the corporation from subchapter S status.

Mr. SAMUELS. Yes, Mr. Chairman. I believe that trusts generally are not able to be shareholders in a subchapter S corporation. I think the reason for that, at least one of the reasons for that, is that there is a limit on the number of shareholders.

Senator BYRD. Yes; 10, I believe.

Mr. SAMUELS. Yes; 10 presently, and the concern would be if you had a trust, as the shareholder, you would be able to have a number of beneficiaries and circumvent the 10 shareholder requirement.

Senator BYRD. Well, could you solve that by specifying that each beneficiary of the trust would be considered as one individual for purposes of the shareholder requirement.

Mr. SAMUELS. Yes, yes, you could, and——

Senator BYRD. Have any recommendations been made to the Congress, do either of you know, in that regard?

Mr. PENNELL. Mr. Chairman, if I may comment, under current law, a so-called grantor trust may be a subchapter S corporation and a trust created under a decedent's will may be a subchapter S corporation shareholder for a limited period of time, time enough for the trust to distribute the shares.

I believe that the President's proposal would make even further liberalization in this area.

In the entire subchapter S area, Mr. Chairman, some years ago a group from the American Bar Association's section of taxation worked closely with Treasury, representatives of the staff of the joint committee, and representatives of the Internal Revenue Service, to develop a number of amendments to subchapter S which were agreed upon by

all parties as being a means of removing many of the traps for the unwary that exist in subchapter S.

Many of those proposals have been adopted in bits and pieces over the years. Certainly, this concept of permitting trusts to be shareholders is one of them and the provisions of the Technical Reform Act of 1976, I believe, went some distance in helping in this respect.

There is still a trap in those because a grantor trust on the death of the grantor ceases to be a grantor trust. Therefore, the subchapter S election is immediately lost, despite the fact that, had a trust been created under the decedent's will, the subchapter S election would not have been lost, for a period of time.

H.R. 6715, the Technical Corrections Act, corrects that error, or would correct it, if it were passed. This is just one of the many areas in which we think H.R. 6715 is an essential piece of legislation.

There have been attempts over the years to improve subchapter S, to make it truly the benefit to small business that the Congress intended it to be when it was passed in 1959 and there are still areas where improvement could be had.

Senator BYRD. Well, as a matter of equity and also to conform with prevailing Treasury views and regulations, what would be the matter with, a subchapter S corporation, or one which desired to be, just to take an example, which had two individuals as stockholders and one individual as trustee for, three other individuals.

All of those added together would be under 10. Would that not be a fair arrangement?

Mr. SAMUELS. Well, there is a potential abuse in that situation, Mr. Chairman, and that is that under subchapter S, there is no tax at the corporate level provided that there is immediate recognition of the income to the shareholders and it is taxed at the shareholders' marginal rate.

Senator BYRD. Right.

Mr. SAMUELS. Now, the three individual shareholders might be in a relatively high income bracket, and therefore, if they interposed the trust between themselves and the subchapter S corporation, they would be able to income split and the trust would then be taxed on the income earned by the subchapter S corporation, but at lower rates, perhaps, than the shareholders would be if the income were taxable currently to the shareholders.

I would like to add to what Mr. Pennell has said that the President's tax program to alleviate the difficulty faced by shareholders in subchapter S corporations in planning their estates, would permit a testamentary trust established under the will of a decedent shareholder to continue to qualify as a shareholder for the term of the trust.

Similarly, upon the death of the grantor of a grantor trust, that trust would qualify as a shareholder. But we would look through to the number of beneficiaries and count them as shareholders, and we would also require the income of that trust to be currently distributable so that it would not accumulate in the trust and thereby split income.

Now, I think to the extent you require the trust to distribute income currently and the number of beneficiaries of the trust were under the number of permitted shareholders, there is no problem.

Senator BYRD. Does the new tax reform proposal provide for that?

Mr. SAMUELS. It does on testamentary trusts, not on inter vivos trusts.

Senator BYRD. Why would it not be appropriate to broaden the proposal to include lifetime trusts? You just mentioned that a trust as a subchapter S shareholder would be satisfatcory for any trust, provided the number were less than 10?

Mr. SAMUELS. And provided all the income were immediately distributable, if it were a simple trust.

Senator BYRD. Right.

Mr. SAMUELS. Well, we do not see the need, I suppose, in that case for the interposition of a trust. I think we could consider expanding our proposal to liberalize subchapter S, to allow a simple trust, all of whose income is distributed and all of whose member beneficiaries were within the permitted number of shareholders to qualify as a shareholder.

Mr. PENNELL. One of the difficulties, Mr. Chairman, in permitting complex trusts, if you will, to be subchapter S shareholders, would be the fact that it would be difficult to tell who the beneficiaries are because of the multitude of variations of beneficial interests and it could become a means of avoiding the 10 or 15 shareholder rule.

With simple trust, where that is generally not the case and the income is currently distributable, the section of taxation believes they could be permitted as shareholders whether or not they are a grantor trust.

Senator BYRD. You mean they could be, under the existing law?

Mr. PENNELL. No; they should be permitted.

Senator BYRD. They should be?

Mr. PENNELL. Yes, sir.

Senator BYRD. Should be; yes. I would think so.

Well, take another case. Two individuals or shareholders in their own right and one individual is a shareholder operating under a trust. Now, would that make a difference? Could the law be changed to permit that, where you only have one person under the trust?

Mr. SAMUELS. Would the trust be required to distribute all income currently or not? To the extent that you allowed the trust to accumulate income there is a potential for income splitting.

Senator BYRD. Yes. But you could provide that the trust could be a part of the subchapter S provided that all of the income was distributed?

Mr. SAMUELS. Yes.

Senator BYRD. But that cannot be done under present law.

Mr. SAMUELS. No; it cannot.

Senator BYRD. Does the President's proposal change this situation?

Mr. SAMUELS. Not with respect to inter vivos trusts other than grantor trusts; it does not.

We will consider that.

Senator BYRD. It seems to me it might be something to consider because often with someone such as a minor daughter or son involved, the owners might want to put the shares in trust. This may not be the case with older sons with business knowledge. Is it not something that you might want to consider changing?

Mr. SAMUELS. Yes; I think we will look into expanding the liberalizations that we have already recommended in the subchapter S rules to include that, although to date, we have not heard from any interested parties of a perceived need to permit that kind of a trust to be a shareholder in a subchapter S corporation.

Senator BYRD. The only reason I bring it up is that occasionally, from time to time, I have been stopped at a dinner or reception and someone brings up this question of a subchapter S where trustees are involved. They are not trying to avoid paying the tax; that is not the purpose of it.

There are other purposes involved of an entirely different nature.

Mr. SAMUELS. Where we have found a problem to exist is in estate planning where a shareholder wants to leave his shares in the subchapter S corporation perhaps to minor children or to his wife under a testamentary trust and we have found that the rules were unnecessarily harsh and the President's program would relax those and permit the shares to be held by a testamentary trust, for the benefit of his wife and children.

Senator BYRD. I assume that, in the case of the stock being owned by an individual but another individual having the voting rights, such a situation would not prevent the use of subchapter S under the present law; would it?

Mr. SAMUELS. As long as that does not create a second class of stock; it would not. I am a little vague, but my recollection is that that is permitted, a voting trust is permitted.

Mr. PENNELL. A voting trust is permitted under the current law.

Senator BYRD. Under the current law?

Mr. SAMUELS. Yes.

Senator BYRD. Thank you, gentlemen, very much.

[The prepared statement of Mr. Pennell follows:]

STATEMENT OF JOHN PENNELL, CHAIRMAN, SECTION OF TAXATION, AMERICAN BAR ASSOCIATION

H.R. 7320 is the first step in an important new process to correct technical deficiencies in the Internal Revenue Code brought to the attention of Congress by the American Bar Association, the American Institute of Certified Public Accountants, and other professional groups. These recommendations are for noncontroversial, technical improvements designed to achieve greater equity and simplicity in our tax laws; they serve to correct the occasional oversight or inconsistency that is inevitable in a tax statute which is as comprehensive and complex as the United States Internal Revenue Code.

H.R. 7320 is devoted for the most part to various timing requirements in the Code that need technical improvement. The American Bar Association wholeheartedly supports all of the provisions of this bill but has suggestions for improvement in two of its provisions.

SECTION 4—COMPLETE LIQUIDATION FOLLOWING INVOLUNTARY CONVERSION

Section 4 adopts in part a recommendation of the American Bar Association that would make it possible to utilize § 337 of the Code in a complete liquidation of a corporation following an involuntary conversion of its property, such as destruction by fire. Section 4 would allow the plan of liquidation to be adopted within 60 days after the involuntary conversion, overcoming the impossibility of adopting the plan under existing law (§ 337) before the sale or exchange of the property (the involuntary conversion) occurs. Obviously the corporation officers cannot adopt a plan of liquidation before the involuntary conversion occurs, in many such cases, because they do not know it will happen (destruction by fire).

Section 4 does not, however, include the balance of the Association's recommendation which would allow the proceeds of the involuntary conversion to be

distributed within 60 days after receipt. Under § 337, the proceeds of the sale or exchange must be distributed within one year after the adoption of the plan of complete liquidation. This is ordinarily feasible, but in the case of an involuntary conversion, receipt of the insurance proceeds or condemnation award is often delayed beyond this period. The insurance adjustment process, or the difficulty of establishing just compensation following a condemnation, often requiring litigation in either case, often delays the receipt of the proceeds under circumstances which the corporation cannot avoid.

It is not feasible to utilize a "liquidating trust" for shareholders in these circumstances in many cases. Such a trust may be held to be an association treated as a corporation under the Code, resulting in loss of the benefits of § 337. Where there is a large number of shareholders, it is often feasible only to use the corporate form because of transfers of shareholder interests and because of various legal uncertainties.

No tax avoidance would occur under the Association's recommendation. The proceeds must be distributed within 60 days after receipt. If the proceeds are freely available to the corporation but are not collected, the doctrine of the constructive receipt will start the running of the 60-day period. All *other* assets of the corporation will still be required to be distributed within 12 months after the adoption of the plan of complete liquidation.

We strongly recommend that section 4 of H.R. 7320 be expanded to include the provision permitting distribution of the proceeds of an involuntary conversion within 60 days after receipt even if this extends beyond the normal one year period for the distribution in complete liquidation under § 337.

SECTION 5—TIME FOR ELECTION OF SUBCHAPTER S TREATMENT

Section 5 would permit an election of Subchapter S status for small business corporations to be made at any time during the taxable year of the corporation preceding the year for which it is to became effective. In the case of new corporations, the election could be made at any time within the first 75 days of its first taxable year. This would liberalize existing law and would prevent some very harsh results that have occurred. This is particularly important to small business, and we strongly support it.

Section 5 is based on a recommendation of the American Bar Association which would have gone somewhat farther by permitting an existing small business corporation to make its Subchapter S election at any time within the proceding taxable year or the first 75 days of the taxable year for year of election. Thus, an existing corporation as well as a new corporation would be given 75 days within which to make the election for the first year it is to become effective. We urge that the Committee expand section 5 of H.R. 7320 to this limited degree so that the 75-day period would be available to existing corporations as well as new corporations.

It is frequently very difficult for corporate officers to decide whether a Subchapter S election should be made until financial data for the preceding year has been accumulated and reviewed. This sometimes is not feasible within the 30-day period for the election permitted by existing law. Often the small business corporation must rely on an outside accountant for these data. Many small business corporations use the calendar year as their taxable year, and accountants are already greatly overburdened in the first month of the calendar year. If the period were 75 days, this problem would be greatly relieved. The 75-day period represents the normal time for filing the corporate return for the preceding year, and ordinarily the financial results of the preceding year will be available within this period.

This will not result in any tax avoidance. The corporate officers still will be required to act well before the pattern of operations for the entire current year will be known, so there will be no opportunity for manipulation.

This will also simplify § 1372 as amended. Section 5 would introduce two separate time periods, one for new corporations and one for existing corporations. We do not think this complication is necessary to protect the revenues.

OTHER MATTERS

We have some technical comments on the drafting of several provisions of H.R. 7320 which are reflected in the several letters from our Committees which are attached to this statement. We have no substantive comments on sections 3, 6, 7, 8, or 9, which we wholeheartedly endorse.

This is an excellent bill, containing important technical improvements in the Internal Revenue Code which are both necessary and entirely non-controversial. We strongly recommend that the Senate Finance Committee favorably report the bill to the Senate as soon as possible.

Enclosures.

TRENAM, SIMMONS, KEMKER, SCHARF & BARKIN,
*Tampa, Fla., June 6, 1977.*

Re H.R. 7320—Comments of the Committee on General Income Tax Problems.

JOHN S. NOLAN, Esquire,
*Miller & Chevalier, 1700 Pennsylvania Avenue NW., Washington, D.C.*

DEAR JOHN: You have asked that we review Section 2 of H.R. 7320.

This provision provides that the 2½ month payment period under § 267(a) is to be extended if the payment period ends on a Saturday, Sunday or a legal holiday to the next succeeding day which is not a Saturday, Sunday or a legal holiday.

We believe that the proposed amendment meets the objectives.

The only possibly confusing portion is the language in Code § 267(e)(2). What is intended by that provision is to state that the determination of what constitutes a legal holiday shall be governed by the rules of § 7503 and that the act involved is the filing of the taxpayer's return for the preceding taxable year. Possibly a clearer approach would be to eliminate the reference to § 7503 and to set forth the rule in § 267(e)(2) to read as follows:

"(2) The term "legal holiday" means a legal holiday in the District of Columbia and also means a Statewide legal holiday in the State in which is located the office where the payor's return of tax under this chapter for the preceding taxable year is required to be filed."

In your subsequent letter, you asked about any other entirely noncontroversial recommendations that might be included in the next bill in the nature of H.R. 7320. In reviewing our prior legislative recommendations, I do not believe that any of them fit in this category.

Sincerely,

ALBERT C. O'NEILL, Jr.

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ISHAM, LINCOLN & BEALE,
*Chicago, Ill., June 16, 1977.*

Re H.R. 7320.

Mr. JOHN S. NOLAN,
*Miller & Chevalier,*
*Washington, D.C.*

DEAR MR. NOLAN: At the request of Ed Hawkins, I am enclosing comments on Section 4 of the above Bill.

Sincerely,

SHARON L. KING.

Enclosure.

EVALUATION OF SECTION 4 OF H.R. 7320, CORPORATE STOCKHOLDER RELATIONSHIPS COMMITTEE

Proposed Section 4 of H.R. 7320 does not contain the recommendation of the American Bar Association that the 12-month distribution requirement under Section 337 be modified where it cannot be met because of delay in receiving conversion proceeds. Specifically, the recommendation was that the distribution requirement would be met if distribution occurred within the prescribed 12-month period or within sixty days after receipt of the proceeds by the corporation, whichever is later. We believe that this flexibility is essential as a practical matter in view of the delays which often occur in collecting conversion proceeds and the difficulties which frequently arise in attempting to make distribution of the claim. We do not foresee a problem of abuse if all other assets are required to be distributed within the 12-month distribution period.

By way of technical comments on the proposed language of Section 4, we believe that reference should be made to "compulsory" as well as "involuntary" conversions to avoid any misunderstanding. Further, we believe that reference to the 12-month period should be clarified by reference to subsection 337(a). We continue to be bothered by the reference to "a complete liquidation" of a corporation because it appears to be a departure from the established language of "distributed in complete liquidation".

SHARON L. KING.

ARENT, FOX, KINTNER, PLOTKIN & KAHN,
*Washington, D.C., June 7, 1977.*

Re H.R. 7320.

LEROY KATZ, Esquire,
*Katz, Kantor, Katz, Perkins & Cameron,*
*Law & Commerce Building, Bluefield, W. Va.*

DEAR LEROY: At your request I have reviewed Section 9 of H.R. 7320. Section 9 provides for a stay of collection of the 100 percent penalty under Section 6672 upon the posting of a bond.

While I agree in principle that the posting of a bond should be available as an option to avoid any extraordinary collection activity, I have a few problems with Section 9 as drafted:

1. Section 9(a) contains a prohibition against the Government making a levy or starting a proceeding in court to collect the "remainder of such penalty" if within 30 days after notice and demand for the penalty "against any person, such person . . . pays . . . the minimum amount required to commerce a proceeding in court with respect to his liability for such penalty . . ."

Traditionally, the Section 6672 penalty is assessed against more than one responsible person, each being assessed the full amount of unpaid taxes subject to the penalty. Often the Government cannot fairly determine by the time of assessment which of the alleged responsible persons will have the penalty sustained against them after litigation or which of all those ultimately adjudicated to be responsible will be able to pay. A recent GAO survey, though using incomplete collection data, found that only about 28% of the unpaid liabilities sought by this penalty/collection device are recovered (CCH 1977 Rulings ¶ 6614 at p. 71,440). In this connection I find that the statute as drafted contains an ambiguity which I would find unacceptable from the Government's standpoint. It is not totally clear that the filing of a bond by one of the persons assessed prohibits collection only as to him.

This ambiguity would be cured by insertion in Line 22 of the bill the language "as to such person" immediately after the words "such penalty." Absent such a change, the statute does not clearly preclude (though it does not fully support) an argument by a solvent president that the payment by a vice president of the same company of the minimal amount needed for suit in a 100% penalty case (one quarter's taxes for one employee—usually slightly over $100), plus the filing by that vice president of a bond for the unpaid portion of "such penalty," precludes collection action against the president as well, even though he filed no bond. If this argument were successful, the actual collection of the full amount of the unpaid taxes may be jeopardized. After the passage of a year or more of litigation, the person who posted the bond may be held not liable and the person who did not may no longer be solvent. Each should be required to post a bond or some form of joint bond covering the liability of each should be posted.

2. A second problem is that there appears to be an inconsistency in philosophy in requiring those who bond off the liability to file suit within 30 days after the denial of their refund claims (Section 9(b)(2)), and yet providing no expedited time period for the filing of a refund claim. Section 9(b)(1)(B). If urgency is at all necessary (and I see no reason for it once a bond is posted) there should be a shortened time period for filing a refund claim as well as for filing suit after denial of the refund claim. Even so, however, out of deference to busy lawyers, we would all want to be given more than 30 days after denial of a refund claim to draft a complaint and file suit. I would suggest that at least 90 days be allowed if there is to be any acceleration of the deadline for filing suit.

3. Consideration should be given to the relationship between Section 9 and the current proposals to grant jurisdiction to the Tax Court to entertain responsible officer suits. I have not done so since I have not been involved in any of the committees' work dealing with those proposals. However, I assume the Court Procedures Committee has been requested to provide its comments on Section 9.

If you have any further questions, please let me know.

Sincerely,

JOHN M. BRAY.

Senator BYRD. Is Mr. Hopkins in the room?

If not, the committee will stand in adjournment.

[Thereupon, at 2:40 p.m., the subcommittee was adjourned.]

# APPENDIX

# DESCRIPTION OF H.R. 7320

PREPARED FOR THE USE OF THE

# COMMITTEE ON FINANCE

BY THE STAFF OF THE

# JOINT COMMITTEE ON TAXATION

## I. INTRODUCTION

The bill described in this pamphlet (H.R. 7320) has been scheduled for a hearing on March 17, 1978, by the Subcommittee on Taxation and Debt Management of the Committee on Finance.

In connection with this hearing, the staff of the Joint Committee on Taxation has prepared a description of the bill. The description indicates the present law treatment, the issue involved, an explanation of what the bill would do, and the effective date. A statement concerning the revenue effect of the bill is set forth in part IV of the pamphlet.

## II. SUMMARY

In general, the bill contains various provisions relating to certain timing requirements of the Federal tax laws. These provisions have been developed from a list of legislative recommendations submitted by the American Bar Association, the American Institute of Certified Public Accountants, and various other groups including State and local bar and accounting associations.

The bill contains provisions relating to the time for (1) payment of expenses owed to related parties, (2) election of special corporate liquidation treatment for involuntary conversions, (3) election of subchapter S status by a corporation, (4) filing of unrelated business income tax returns for exempt organizations, (5) determining the status of a taxpayer as a farmer or fisherman for estimated income tax purposes, (6) claiming credits or refunds arising from carrybacks, and (7) collection of the penalty for failure to pay over withholding taxes where a bond is furnished. In addition to these timing provisions, the bill provides a basis adjustment for property distributions received by a corporation where gain is recognized by the distributing corporation.

## III. DESCRIPTION OF PROVISIONS

### A. Period for Payments to Qualify for Deductibility of Certain Expenses Paid to Related Taxpayers (sec. 2 of the bill and new sec. 267(e) of the Code)

*Present law*

Under present law (sec. 267(a)), an accrual basis taxpayer is denied a deduction for certain accrued expenses or interest owed to certain related persons who are on the cash basis. The disallowed interest and expenses are those which are not paid to the related person, or are not constructively received by the related person, within the taxable year in which the expenses are accruable, or within 2½ months thereafter. This provision prevents an accrual-basis taxpayer from claiming a deduction for an accrued expense which the related cash-basis payee is not required to take into income until some subsequent time, if at all.

Because an accrued expense is deductible by a taxpayer under the accrual method of accounting only in the taxable year in which it accrues, a deduction disallowed under section 267(a) is permanently lost. It cannot be deducted at some subsequent time when payment is made.

In determining whether certain acts are performed timely, present law (sec. 7503) generally provides that when the last day for performing any act falls on a Saturday, Sunday, or legal holiday, the act is timely if it is performed on the next succeeding day which is not a Saturday, Sunday, or legal holiday. However, the Internal Revenue Service has ruled that this provision applies only to procedural steps in connection with the determination, collection, or refund of taxes, and does not extend the 2½-month period (under section 267(a)) during which accrued expenses owed to a related person must be paid by the taxpayer, or constructively received by the related person (Rev. Rul. 72-541, 1972-2 CB 645).

*Issue*

The issue is whether the required payment period under section 267 (a) should be extended if the payment period ends on a Saturday, Sunday, or legal holiday.

*Explanation of the provision*

This provision applies the timely performance rule relating to holidays (sec. 7503) in determining the period within which accrued expenses owed to a related taxpayer must be paid (sec. 267(a)). As a result, the 2½-month period under section 267(a) during which payments must be made (or constructively received) in order to be deductible is to be extended if the period ends on a Saturday, Sunday, or legal holiday.

Under the bill, the determination of what constitutes a "legal holiday" is to be made under section 7503. For this purpose, a legal holiday must be a holiday recognized throughout the State where the payor is considered to reside for purposes of filing the payor's income tax return for the preceding taxable year.

*Effective date*

This provision applies with respect to payments made after the date of enactment of the bill.

## B. Increase in Basis for Amount of Gain Recognized to the Distributing Corporation (sec. 3 of the bill and secs. 301(b)(1)(B), 301(d)(2), and 312(c) of the Code)

*Present law*

Under present law (sec. 301(b)(1)(B)), if property is distributed by a domestic corporation to a shareholder which is a domestic corporation, the amount of the distribution treated as a dividend to the distributee corporation is an amount equal to the lesser of (1) the fair market value of the property received, or (2) the adjusted basis of the property to the distributing corporation, plus any income or gain recognized by the distributing corporation upon the distribution pursuant to certain designated Code sections.[1] These designated Code sections provide for recognition of gain upon the disposition of certain types of property, such as LIFO inventory, properties subject to indebtedness in excess of basis, appreciated property used to redeem stock, real and personal property on which depreciation was claimed, farmland, and interests in oil or gas properties. Corresponding rules apply in determining the reduction in the earnings and profits of the distributing corporation (sec. 312(c)).

*Issue*

The issue is whether a general provision should be provided to allow an adjustment to basis for a distributee-corporation where gain is recognized upon the distribution of property by the distributor-corporation.

*Explanation of the provision*

The bill provides that the amount of an in-kind property distribution and the basis of the property to a distributee-corporation is to be increased by any gain recognized to the distributing corporation on the distribution. The bill also provides that the earnings and profits of the distributing corporation are to be adjusted for any gain recognized by it upon the distribution (rather than just the gain recognized pursuant to specified Code sections).

*Effective date*

This provision applies to distributions made after the date of enactment of the bill.

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[1] Sections 311(b), (c), and (d), 341(f), 617(d)(1), 1245(a), 1250(a), 1251(c), 1252(a), and 1254(a).

## C. 60-Day Extension of 12-Month Period for Nonrecognition of Gain in Connection With Certain Liquidations Where There is an Involuntary Conversion (sec. 4 of the bill and sec. 337 of the Code)

*Present law*

Under present law, a corporation, which adopts a plan of complete liquidation and within 12 months thereafter distributes all of its assets to its shareholders, does not recognize gain or loss on the sale of property during the 12-month period. Prior to the enactment of this provision of the Code (sec. 337), a sale of property by a corporation which subsequently liquidated generally resulted in two taxes—one tax on the corporation on the gain realized on the sale, and a second tax on the shareholders on the gain realized by them when they received the proceeds from the corporation in complete liquidation of their stock. Prior to enactment of section 337, the tax on the sale could generally be avoided only by a distribution of assets to the shareholders in a taxable liquidation followed by a sale under which gain was not realized because the bases of the assets were equal to the sales price. The Congress changed the law in 1954 because these differences accorded undue weight to the formalities of the transaction and they, therefore, represented a trap for the unwary. In such cases, the Congress decided to eliminate the tax at the corporate level. Section 337 generally eliminates the distinction between (1) a distribution of assets followed by a sale (one tax) and (2) a sale followed by a distribution of sale proceeds to shareholders (two taxes).

The three major requirements of current law are: (1) that a plan of complete liquidation be adopted on or before the date of the sale or exchange, (2) that the sale or exchange occur within the 12-month period beginning on the date of adoption of the plan, and (3) that all proceeds (less assets retained to meet claims) be distributed in complete liquidation within the 12-month period.

Under present law, an involuntary conversion of property which results from a fire or condemnation proceeding is a "sale or exchange" eligible for nonrecognition of gain or loss under this provision. In the case of a fire, the Supreme Court has held that the sale or exchange occurs at the time of the fire even if the insurance proceeds are not determinable at that time. *Central Tablet Manufacturing Co.* v. *U.S.*, 417 U.S. 673 (1974). Similarly, the transfer of ownership to the State in the case of condemnation constitutes a "sale or exchange," even if the owner did not have notice of the action. In some States, filing of documents in court is sufficient to transfer ownership of the condemned property, and subsequent litigation as to the amount of the condemnation award does not change the date of "sale" for purposes of the 12-month liquidation provision.

In the case of destruction of property by fire or other casualty, it is difficult if not impossible to take action to adopt a plan to liquidate on the date the fire or other casualty occurs.[1] If a corporation decides

[1] Under the statute, the nonrecognition provision applies to sales or exchanges taking place on or after the date the plan is adopted.

to liquidate after an involuntary conversion, any gain arising from the involuntary conversion is subject to two incidences of taxation if the corporation did not adopt a plan of liquidation on the date of the involuntary conversion or did not happen to have a plan in existence before the date of the conversion. Similar considerations arise in connection with condemnations. If the taxpayer has little knowledge of an impending condemnation, then the corporation may be unable to adopt a plan of liquidation on or before the date of the condemnation.

*Issue*

The issue is whether a special nonrecognition rule should be provided in the case of certain corporate liquidations where there is an involuntary conversion.

*Explanation of the provision*

The bill extends nonrecognition treatment to gain or loss resulting from the destruction, theft, seizure, requisition, or condemnation of property, or from the sale or exchange of property under the threat or imminence of requisition or condemnation, if a plan of liquidation is adopted within 60 days after the date the involuntary conversion occurs, and the liquidation otherwise qualifies under the 12-month liquidation provision (sec. 337). However, this additional nonrecognition provision will apply only if the liquidating corporation so elects, at such time and in such manner as may be prescribed in Treasury regulations. If the nonrecognition election is made, it will apply to all gains and losses from all involuntary conversions occurring during the 60-day period.

*Effective date*

The provision applies to involuntary conversions occurring after the date of enactment of the bill.

### D. Extension of Period for Making Subchapter S Elections (sec. 5 of the bill and sec. 1372(c) of the Code)

*Present law*

Subchapter S was enacted in 1958 in order to minimize the effect of Federal income taxes on the form in which a business is conducted by permitting incorporation and operation of certain small businesses without the incidence of income taxation at both the corporate and shareholder levels. The subchapter S rules allow corporations engaged in active trades or businesses to elect to be treated for income tax purposes in a manner similar to that accorded partnerships. Where an eligible corporation elects under the subchapter S provisions, the income or loss (except for certain capital gain) is not taxed to the corporation, but each shareholder reports a share of the corporation's income or loss each year in proportion to his share of the corporation's total stock. Once made, the election continues in effect for the taxable year and subsequent years until it is terminated.

Present law requires that in order for a subchapter S election to be effective for a taxable year, it must be filed during a limited 2-month period which begins one month before the start of the taxable year. (For example, if a calendar year corporation wishes to elect sub-

chapter S effective for 1978, the election must be filed during December of 1977 or January of 1978.) An election is not valid for either the intended year or any future year if it is not filed within this period. Extensions of time for filing the election are not granted. Rev. Rul. 60–183, 1961–1 C.B. 625. If an election is found to be untimely upon audit several years later, the corporation is taxed as a regular corporation for all the intervening years. *Opine Timber Co., Inc.*, 64 T.C. 700 (1975); *Joseph W. Feldman*, 47 T.C. 329 (1966).

In effect, the period of time during which an election can be made by a newly-formed corporation for its first taxable year is only one month since a new corporation cannot make the election until it is in existence under State law, which generally occurs at the same time as the beginning of its first taxable year. *J. William Frentz*, 44 T.C. 485 (1965), aff'd, 375 F.2d 662 (6th Cir. 1967). In other situations it has been difficult to determine when the one-month period begins for a new corporation to make the election because of several alternative rules used to determine when its first taxable year begins.

*Issue*

The issue is whether the period for making the subchapter S election should be expanded.

*Explanation of the provision*

Under the bill, the period of time to make the subchapter S election is expanded to include the entire preceding taxable year for small business corporations. In addition, a newly-formed corporation may make the election during the first 75 days of its first taxable year, rather than the one-month period provided under present law.

*Effective date*

This provision is effective for subchapter S elections made more than 60 days after date of enactment but only for taxable years which begin more than 60 days after the date of enactment.

In addition, if certain conditions are satisfied, the perfection of an election, which was made before the provision is generally effective and which was not timely filed, is permitted as to the corporation's taxable year following the taxable year in which the original election was filed. The small business corporation must have filed an income tax return for that year as an electing corporation and file a perfecting election (at the time and in the manner prescribed by Treasury regulations). All persons who were shareholders of the corporation (at any time during the period beginning with the first taxable year to which the perfecting election applies and ending with the date of making the perfecting election) must consent to the making of the election. The shareholders must also consent to an extension of the statute of limitations for assessing any deficiencies attributable to the election, which would otherwise be barred, for a one-year period after the date of filing the perfecting election. The perfecting election must apply to the corporation's first taxable year following the taxable year in which the original election was filed and to subsequent taxable years. Similarly, the election will relate to the shareholders' taxable years affected by perfecting the corporation's status as an electing small business corporation.

## E. Time for Filing Income Tax Returns in the Case of Organizations Exempt from Taxation Under Section 501(a) (sec. 6 of the bill and sec. 6072 of the Code)

*Present law*

Under present law, income tax returns on the unrelated business taxable income of calendar year corporations exempt from tax under section 501(a) of the Code must be filed on or before the 15th day of March following the close of the calendar year, and such returns made on the basis of a fiscal year must be filed on or before the 15th day of the third month following the close of the fiscal year.[1] Similarly, trusts exempt from tax under section 501(a) must file income tax returns on their unrelated business taxable income on or before the 15th day of April in the case of returns made on the basis of the calendar year, or, in the case of returns made on the basis of the fiscal year, on or before the 15th day of the fourth month following the close of the fiscal year.[2] However, annual information returns of these exempt organizations (other than certain religious or apostolic organizations) must be filed on or before the 15th day of the fifth calendar month following the close of the taxable year.[3] Thus, the due date for an exempt organization's information return is different from the due date for the organization's income tax return.

*Issue*

The issue is whether the due dates for filing the unrelated business income tax return and the annual information return for an exempt organization should be conformed.

*Explanation of the provision*

The provision generally conforms the due date for an exempt organization to file a return of unrelated business income to the due date for filing an annual information return. Under this provision, an organization exempt from tax under section 501(a), other than an employees' trust described in section 401(a), must file its income tax return on or before the 15th day of the fifth month following the close of the taxable year. For a calendar year organization, the return would have to be filed by May 15.

*Effective date*

This provision applies to returns for taxable years beginning after the date of enactment of the bill.

## F. Period for Determining Whether the Taxpayer is a Farmer or a Fisherman for Purposes of the Estimated Tax (sec. 7 of the bill and sec. 6073(b) of the Code)

*Present law*

Under present law, an individual generally is required to file quarterly declarations of estimated income tax if his tax liability not covered by withholding can be expected to be $100 or more and he will have a certain amount of gross income or nonsalary income (secs.

[1] Sec. 6072(b).
[2] Sec. 6072(a).
[3] Treasury regulations § 1.6033-2(e).

6015 and 6073). An addition to tax generally is imposed on an underpayment of estimated tax. The rate of this addition to tax is equal to the interest rate on underpayments of tax and is based on the amount of underpayment for the time between the due date of the estimated tax payment and the due date of the tax return unless one of several exceptions apply (sec. 6654).

However, special provisions apply to farmers and fishermen. Under these provisions, an individual may postpone the filing of an estimated tax return (and the payment of estimated taxes) for a taxable year until January 15th of the succeeding taxable year if his estimated gross income from farming or fishing for the taxable year is at least two-thirds of the total estimated gross income from all sources for the taxable year.[1]

*Issue*

The issue is whether the special rules for filing estimated tax returns in the case of farmers and fishermen should be available if the requirements are satisfied on the basis of gross income for the preceding taxable year.

*Explanation of the provision*

The bill extends the exception from quarterly declarations of estimated tax so that the special rule for farmers and fishermen also applies when at least two-thirds of the gross income shown on an individual's tax return for the preceding taxable year was gross income from farming or fishing.

*Effective date*

This provision applies to declarations of estimated tax for taxable years beginning after the date of enactment of the bill.

## G. Period of Limitations for Credit or Refund With Respect to Certain Carrybacks of Losses and Credits (sec. 8 of the bill and sec. 6511 of the Code)

*Present law*

Under present law (sec. 6511(d)(2)(A)), a claim for refund or credit attributable to a carryback of a net operating loss or capital loss must be filed within 3 years of the due date of the corporate or individual tax return for the taxable year of the loss, without regard to any extensions of time which may be granted for filing the return (including automatic extensions) unless a written extension of the period of limitations on assessment is obtained. Similar rules apply with respect to the carryback of the investment credit, work incentive credit, and new jobs credit.

Since, under present law, a claim for refund attributable to a carryback of a net operating loss, capital loss, or the previously-mentioned credits must be filed within 3 years of the return due date determined without regard to any extension of time, it is possible for a carryback claim to be barred by the statute of limitations at a time that deficien-

[1] Also, an individual who qualifies for deferral of estimated tax payments under this rule is not required to make a declaration of estimated tax or payment of estimated tax on January 15th, if he files a tax return on or before March 1 of the following year and pays the full amount of tax at that time (sec. 6015(f)).

cies attributable to the carryback may still be assessed, or that a claim for refund of the current year's tax is not barred by the statute of limitations.

*Issue*

The issue is whether the limitation period for filing claims with respect to loss carrybacks, where the taxpayer has filed a timely return for the loss year, should be the same as the limitation period for asserting deficiencies attributable to the carryback.

*Explanation of the provision*

The provision amends section 6511(d)(2)(A) to provide that a claim for credit or refund relating to an overpayment attributable to a net operating loss carryback or a capital loss carryback may be filed within 3 years after the time for filing the return, including extensions, for the loss year. A similar rule applies to the carrybacks of the investment credit, the work incentive program credit, and the new jobs credit.

*Effective date*

The provision applies to carrybacks arising in taxable years beginning after the date of enactment of the bill.

## H. Stay of Collection of Penalty Under Section 6672 When Bond is Filed (sec. 9 of the bill and sec. 6672 of the Code)

*Present law*

Present law (sec. 6672) imposes a civil penalty upon any person who is required to but willfully fails to collect or pay over any tax imposed by the Internal Revenue Code. The penalty is equal to the amount of tax which has not been collected or paid over. This penalty, commonly called the 100-percent penalty for failure to pay over, applies not with regard to the personal tax liability of the person potentially subject to the penalty but rather to the tax for which another person is primarily liable, e.g., an employer's liability for payroll withholding.[1]

In the case of Tax Court litigation, a taxpayer need not pay a deficiency asserted by the Government until the final adjudication of his case, and the Government may not levy on his property or begin any other collection procedure in the meantime.[2] However, the 100-percent penalty is not subject to Tax Court jurisdiction. Instead, the person subject to the penalty generally is restricted to filing with the Internal Revenue Service a claim for refund for the penalty after it has been paid or collected. If the Service denies the claim (or fails to respond

[1] The Supreme Court granted certiorari in October, 1977, for two cases involving the penalty for failure to pay over withholding taxes. One case involves the dischargeability of the penalty in a bankruptcy proceeding (*In re Sotelo*, 551 F.2d 1090 (7th Cir. 1977) and the other case involves an officer-shareholder's responsibility for payment of withholding taxes attributable to wages paid before acquiring control of the corporate taxpayer (*In re Slodov*, 552 F.2d 159 (6th Cir. 1977)).

[2] In the case of jeopardy assessments, immediate assessment and collection may be made, but a new provision was added under the Tax Reform Act of 1976 to obtain expedited administrative and judicial review of jeopardy assessments (secs. 6331, 6861, 6862, and 7429).

within 6 months), a suit for refund can be filed in either a U.S. district court or the Court of Claims.[3]

Thus, under present law, there is generally no procedure whereby the person subject to penalty may stay enforcement of the penalty pending a judicial determination. The Internal Revenue Service may assess the penalty immediately after it is determined and, 10 days after notice and demand for payment is made, enforce the assessment by various collection procedures, including a seizure of the property of the person assessed with the penalty.

*Issue*

The issue is whether the person against whom assessment is made should be able to post a bond and thereby stay enforcement of collection of the 100-percent penalty under section 6672.

*Explanation of the provision*

The bill provides a stay of collection proceedings against a person assessed with the 100-percent penalty if, within 30 days after the date of notice and demand for payment of the penalty, he posts a bond equal to one and one-half times the amount of the assessed penalty. The stay of collection would not apply if it is determined that collection of the penalty will be jeopardized by delay. In addition, the person posting the bond must pay an amount sufficient to initiate refund litigation (in the case of a penalty resulting from nonpayment of employment taxes, this would be the withholding taxes attributable to one individual), file a refund claim, and begin court proceedings within 30 days after a denial of the refund claim.

The bonds submitted under this provision are to be in the form and with such surety or sureties as may be prescribed by the Secretary of the Treasury or his delegate. However, the person required to furnish the bond may choose instead to deposit obligations of the United States.

After the posting of a bond under this provision, collection proceedings would be stayed until such time as there is a final resolution of the court proceedings in favor of the Government.

While the collection proceedings are stayed, the running of the period of limitations during which the penalty may be collected would be suspended for the period of the stay of collection proceedings.

*Effective date*

This provision applies to penalties assessed more than 60 days after enactment of the bill.

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[3] The 100-percent penalty is frequently imposed on account of a failure to pay over withholding employment taxes. These are separate taxes as to each individual, and the position of the IRS as to whether individuals are employees or independent contractors can be challenged by paying the amount of the withholding taxes for only one of those individuals and suing for a refund of that amount. In addition, the plaintiff could demand abatement of the penalty attributable to the withholding taxes of the other individuals whose status is questioned. However, even in this situation, the Government could file liens and levy on the plaintiff's property for the amount of the penalty that is not yet paid. *Mazzei v. United States*, 548 F.2d 295 (10th Cir. 1977), certiorari denied, 431 U.S. 967 (1977).

## IV. REVENUE EFFECT

It is estimated that the provisions contained in the bill, H.R. 7320, will not have any significant revenue effect.

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