Calendar No. 682

83D CONGRESS, 1st Session | SENATE | REPORT No. 685

# AMENDING THE INTERNAL REVENUE CODE TO EXTEND THE TIME DURING WHICH CERTAIN PROVISIONS RELATING TO INCOME AND ESTATE TAXES SHALL APPLY

JULY 28 (legislative day, JULY 27), 1953.—Ordered to be printed

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

## REPORT

[To accompany H. R. 6426]

The Committee on Finance, to whom was referred the bill (H. R. 6426) to amend the Internal Revenue Code to extend the time during which certain provisions relating to income and estate taxes shall apply, and for other purposes, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

The amendments are as follows:

Section 204 (a) is amended by striking out lines 17 through 25, inclusive, on page 10 and lines 1 through 8, inclusive, on page 11 and inserting in lieu thereof the following:

(a) AMENDMENT OF SECTION 116 (a) (2).—Section 116 (a) (2) (relating to exclusion from gross income of earned income from sources without the United States) is hereby amended by adding at the end thereof the following new sentences: If the 18-month period includes the entire taxable year, the amount excluded under this paragraph for such taxable year shall not exceed $20,000. If the 18-month period does not include the entire taxable year, the amount excluded under this paragraph for such taxable year shall not exceed an amount which bears the same ratio to $20,000 as the number of days in the part of the taxable year within the 18-month period bears to the total number of days in such year.

Page 12, line 1, strike out "April 14, 1953" and insert:

December 31, 1952, but only to such amounts as are received on or after January 1, 1953.

Page 29, line 11, strike out "July" and insert in lieu thereof "June" and on page 30, line 1, strike out "July" and insert "June."

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## I. GENERAL STATEMENT

H. R. 6426 contains 17 sections dealing with amendments to the Internal Revenue Code. Six of the sections extend the period during which certain provisions of the code will apply. The other 11 sections relate to amendments to the Internal Revenue Code providing for removal of inequities in income- and estate-tax cases. Your committee believes that it is important to take care of these inequities ahead of the general revision bill which will be considered next year.

## II. EXPLANATION OF THE BILL

### A. Extension Provisions

*Section 101. Election as to recognition of gain in certain corporate liquidations*

This section extends to 1953 the provisions of section 112 (b) (7) of the Internal Revenue Code dealing with the nonrecognition of gain in certain corporate liquidations. This provision which applied to certain liquidations in a single calendar month in 1951 was extended by the Revenue Act of 1951 to such liquidations in 1952 and is further extended by this bill to such liquidations occurring in a single calendar month in 1953. Your committee believes that such an extension for 1 year is desirable to enable those who were unable to arrange for liquidation within the requisite period in 1951 or 1952 to have the benefits of this provision if they can complete such liquidations in a single calendar month in 1953.

*Section 102. Extension of time for elections under Public Law 539 overruling Virginian Hotel case*

In Public Law 539, approved July 14, 1952, Congress overruled the decision of the Supreme Court in the Virginian Hotel case. Under that decision a taxpayer who deducted depreciation for any year in excess of the amount allowable for such year was nevertheless required to reduce the basis of his property by the entire amount of depreciation allowed, even though he had received no tax benefit from claiming such excessive depreciation as a deduction. Under Public Law 539, the basis of the property was not required to be reduced by such excessive depreciation unless the taxpayer had received a tax benefit for taking a deduction for such excessive amount. The taxpayer was granted under the law an election (under such regulations as the Secretary prescribed) to apply this new treatment retroactively to the period since February 28, 1913, and before January 1, 1952, but no election could be made after December 31, 1952. The Treasury Regulations under the law were not promulgated until December 30, 1952. Thus taxpayers were not given sufficient time to determine whether such an election would be beneficial to them. Your committee therefore deems it desirable to extend through December 31, 1954, the time within which an election may be made. Since Public Law 539 provides that an election once made is irrevocable, the bill, in order to provide uniform treatment, permits taxpayers to revoke within the extended period elections made prior to January 1, 1953.

*Section 103. Extension of time for making election with respect to war loss recoveries*

Section 341 of the Revenue Act of 1951 sets forth a new method for treatment of war losses under section 127 of the Internal Revenue Code. It provides that at the election of the taxpayer (under such regulations as the Secretary may prescribe) the tax for the year in which the deduction for the war loss was taken is to be recomputed by reducing the deduction by the amount of the recovered property taken at its depreciated cost on the date of the loss or at its fair market value on the date of recovery, whichever is lower. The resulting increase in tax for the year of the loss, if any, is added to the tax for the year of recovery. The time for electing the benefit of this provision expired on December 31, 1952. Since the Treasury Regulations interpreting this section of the law were not promulgated until December 30, 1952, taxpayers did not have sufficient time to determine whether it was advantageous to make such an election. The bill extends the period for making such an election through December 31, 1953.

*Section 104. Extension of period of abatement of income taxes of deceased members of Armed Forces*

Section 154 of the Internal Revenue Code provides in the case of an individual who died after June 24, 1950, and prior to January 1, 1954, as a result of active service in a combat zone as a member of the Armed Forces, an abatement of income tax liability which was outstanding at the date of his death. It also provides a forgiveness of the tax with respect to the taxable year in which falls the date of his death or with respect to any prior taxable year ending on or after the first day he so served in a combat zone after June 24, 1950. The bill extends the period to which this section is applicable for one additional year so as to include the calendar year 1954.

*Section 105. Extension of temporary provisions relating to life-insurance companies*

The present temporary provisions for the taxation of life-insurance companies are extended for 1 year by this section of the bill. Pending the results of studies being made by the staffs of the Treasury and the Joint Committee on Internal Revenue Taxation, your committee deems it advisable to continue for 1 year the provisions of present law.

*Section 106. Extension of period for exemption from additional estate tax of deceased members of Armed Forces*

Section 939 (b) of the Internal Revenue Code exempts from the additional estate tax estates of decedents dying after June 24, 1950, and before January 1, 1954, while in active service as members of the Armed Forces of the United States, where such decedents were killed in action while serving in a combat zone or died from wounds, disease, or injury incurred while so serving in line of duty and by reason of a hazard to which they were subjected as an incident of such service. The bill extends the application of this section to January 1, 1955.

## B. Miscellaneous

*Section 201. Venue of action for violation of State cigarette tax laws*

The act of October 19, 1949, provided that persons, other than distributors, who sell or dispose of cigarettes in interstate commerce must forward to the tobacco tax administrators of States to which shipments are made monthly reports setting forth the names and addresses of the persons to whom shipments are made and the brand and quantity of cigarettes so shipped. Some courts have held that under the statute violations of the act are committed at the place from which the cigarettes are shipped, since the act only requires the shippers to forward their reports. The bill requires the actual filing of the reports with the State tobacco administrator. This would have the effect of assuring, in the event of an offense committed under the act, that the venue of the action would be in the district in which the State tobacco administrator has his office.

*Section 202. Deduction of certain unpaid expenses and interest*

In the case of certain closely related taxpayers, such as a corporation and a shareholder owning more than 50 percent of the corporation's stock, section 24 (c) of the code operates to disallow deduction of certain expenses and interest if the following conditions are met:

(1) The amount is not paid within the taxable year or within 2½ months after the close thereof; and

(2) Under the recipient's method of accounting the amount is not, unless paid, includible in his income in the taxable year in which, or with which, the taxable year of the payor corporation ends.

This provision is intended to insure that transactions between such related taxpayers do not operate to shift items of income or deductions. A situation has been called to the attention of your committee, however, where section 24 (c) may work an undue hardship. For example, a recipient on the cash basis may have an amount credited to his account and made available to him by the corporate payor within 2½ months after the close of the payor's taxable year so that the recipient must include it in income as an item constructively received in the taxable year so credited. If, however, the corporate taxpayer fails actually to pay over such amount within the period of 2½ months, the item will not be allowed to the corporation as a deduction. Your committee believes that such a case should not fall within the ban of section 24 (c) and the bill so provides by an appropriate amendment of requirement (1) above.

The provision is applicable to taxable years of the payor beginning after December 31, 1950, but under certain conditions, set forth to insure that payments will be properly accounted for taxwise with respect to both parties, the payor may elect to make this amendment applicable to taxable years beginning after December 31, 1945, and before January 1, 1951.

*Section 203. Income-tax basis of property transferred in trust*

Section 113 (a) (5) of existing law contains a provision to the effect that where the grantor retains the income from property in trust for his life with power to revoke the trust, the basis of the property in the hands of the persons entitled to take the property under the terms of the trust instrument after the grantor's death shall, after such death, be the same as if the property had passed under a will executed on the

day of the grantor's death. This results in the basis of the property in the hands of the recipients being its fair market value at the date of the grantor's death or, at the election of the executor, the value 1 year from the date of death. Your committee believes that this same rule should apply to situations where the grantor with a reserved life estate has the power to make any change in the enjoyment of the corpus of the trust through the power to alter, amend, or terminate the trust. In both cases, the trust property is required to be included in the gross estate of the grantor for estate-tax purposes. The amendment applies only to grantors dying after December 31, 1951, and only with respect to taxable years ending after December 31, 1951.

*Section 204. Earned income from sources without the United States*

Your committee deems it advisable to amend section 116 (a) (2) of the Internal Revenue Code, effective as to amounts received after December 31, 1952. Section 116 (a) (2) excludes from income in the case of a citizen of the United States income earned abroad if such citizen was present in a foreign country or countries for a period of 17 out of 18 consecutive months. While this paragraph was designed to encourage men with technical knowledge to go abroad in order to complete specific projects, it has been subject to a great deal of abuse. Some individuals with large earnings have seized upon the provision as an inducement to go abroad to perform services, which were customarily performed at home, for the primary purpose of avoiding the Federal income taxes. It has also been ascertained that in many cases Americans taking advantage of this provision do not pay any income tax even to the foreign country or countries in which the income is earned. This is because they are not in any particular foreign country long enough to establish a residence or because the foreign country in question does not impose any income tax. Under the House bill, section 116 (a) (2) of the Internal Revenue Code is repealed effective as of April 15, 1953. Under your committee amendment, section 116 (a) (2) is retained but is limited to $20,000 of earned income if the taxpayer is abroad for the full taxable year or to a portion thereof if the taxpayer is abroad for less than the full taxable year. While the committee amendment applies to taxable years ending after December 31, 1952, it will cover only such amounts as are received on or after January 1, 1953. Your committee believes that an outright repeal of section 116 (a) (2) is not necessary to correct the reported abuses under existing law. There are many legitimate business arrangements which necessitate sending technical personnel abroad. A limitation on the amount of the earned income from foreign sources which is exempt will, in the opinion of your committee, be sufficient to correct the evils which have been brought to its attention. The bill will not affect the liability of any employer to deduct and withhold the tax on remuneration paid before the 1st day of the 1st month beginning more than 10 days after the date of the enactment of this bill. For the purpose of this provision, if an individual travels from one place in a foreign country to another place in the same country, or to a place in another foreign country and if such travel extends over a period of less than 24 hours and does not involve travel within the United States or any possession thereof, such individual shall not be deemed outside a foreign country during the period of such travel.

*Section 205. Net operating loss deductions*

The bill includes provisions designed to eliminate disparities in the treatment of taxpayers in respect to the taxable years to which a net operating loss may be carried forward. Under these provisions the number of years to which a net operating loss may be carried forward by certain corporations reporting income on the basis of a fiscal year has been extended. Under the cutoff dates in existing law these corporations are limited in the use of their net operating losses. For example, under existing law, if a corporation has a taxable year beginning on December 1, 1947, a net operating loss developed in that year may only be carried forward to the 2 succeeding taxable years whereas if the taxable year had begun on January 1, 1948, such may be available to offset gains of the 3 succeeding taxable years.

It is provided that in the case of a corporation, other than a corporation which commenced business after December 31, 1945, which has a net operating loss for a taxable year beginning in 1947 and ending in 1948 (so that the taxable year overlaps the critical dates) such a corporation may utilize such loss in the third succeeding taxable year. The amount of such carryover to the third year cannot exceed an amount which bears the same ratio to the net operating loss as the number of days in the loss year falling after December 31, 1947, is of the total number of days in the loss year.

In the case of a corporation the first taxable year of which began in 1949 and ended in 1950, a comparable extension is provided. Such corporations are put on a basis similar to that provided for corporations with net operating losses for taxable years beginning after 1949, that is, the net operating loss may be available for the 5 succeeding taxable years. However, the bill subjects the amount of the carryover to the fourth and fifth succeeding taxable years to a general limitation to such part of the net operating loss as is properly allocable to 1950.

The bill adds a provision amending section 1 of the act of July 15, 1947 (61 Stat. 324). This act allowed a carryforward of the net operating loss of a predecessor railroad corporation to a successor railroad corporation. Since the reorganization may have caused a short taxable year of the predecessor and of the successor to fall within one 12-month period, such corporations would, in effect, be denied the full 2-year carryforward available to other corporations, the act allowed a carryover for 3 taxable years in such cases. Section 330 (b) of the Revenue Act of 1951 added section 122 (b) (2) (C) to the code which provided, in the case of all corporations, for a 3-year carryforward of a net operating loss incurred for any taxable year beginning after December 31, 1947, and before January 1, 1950. Accordingly the bill would allow a successor railroad corporation a 4-year carryover in order to continue the prior treatment under the act of July 15, 1947.

*Section 206. Amortization deduction for grain-storage facilities*

A critical shortage of facilities for storing grain has developed throughout the Nation during the past several years. This shortage has been felt particularly by producers of such grains as wheat and corn. In view of the situation which has arisen, it is believed necessary to provide an inducement for taxpayers to construct new grain-storage facilities, to increase the capacity of those already in existence, or to adapt existing construction to the storage of grain.

Under existing law, a taxpayer undertaking such expenditures would be allowed to recover his costs only through a deduction for depreciation taken over the period of the useful life of such new construction or adaptation. The bill adds section 124B to the code to allow such costs in the case of construction or adaptation after December 31, 1952, and before January 1, 1957, to be deducted, at the taxpayer's election, over the period of 60 months beginning either with the month following the month in which the facility was completed, or with the succeeding taxable year. In the event that the shortage of facilities for storing grain remains in a critical state through 1956, it would be appropriate to extend the date within which a taxpayer may construct such facilities and receive the benefits of this provision. The deduction is available only with respect to taxable years ending after the date of the enactment of this act. In the case of new construction the deduction is only available with respect to so much of the cost as is attributable to construction after December 31, 1952, and in the case of the alteration or adaptation of existing buildings only such cost as is properly attributable thereto after such date may be so deducted.

This amortization deduction is in lieu of that allowed for depreciation, but a taxpayer is allowed to deduct ordinary depreciation for that part of his costs of construction which would not qualify under this section, for example, by reason of not having been incurred subsequent to December 31, 1952. A taxpayer may elect to discontinue his amortization deductions under this section as of the beginning of any month specified in a notice filed with the Secretary before the beginning of such month and may thereafter be allowed the depreciation deduction. In the case of property held by one person for life with remainder to another, the life tenant is allowed the deduction under this section as if he were the absolute owner. Special rules are provided to allow the benefits of this deduction to a person acquiring a grain-storage facility to which this section is applicable. These rules are discussed in the technical part of this report relating to this provision.

This special amortization deduction is available to a farmer constructing a grain-storage facility. The statute defines a grain-storage facility as a corncrib, grain bin, or grain elevator, or any similar structure primarily suited for the storage of grain, which is intended by the taxpayer at the time of his election to be used for the storage of grain produced by him. The deduction is also available to any person who constructs any public grain warehouse permanently equipped for handling grain. Under the definition of a grain-storage facility the special amortization deduction is not allowed to persons who store only grain purchased for consumption in their business. For example, persons engaged in the milling of flour who construct storage facilities for purchased grain used in such processing would not be allowed to deduct the cost of any facilities under this provision.

*Section 207. Exclusion of certain transfers taking effect at death*

The bill amends the estate-tax provisions of the code relating to certain transfers of property with retention of the income for life by the transferor. In 1930 the Supreme Court held that property so transferred should not be included in the taxable estate of the transferor. *May* v. *Heiner* (281 U. S. 238). In response to this and re-

lated decisions, on March 3, 1931, Congress adopted a joint resolution providing that such transfers were includible (46 Stat. 1516), and the Revenue Act of 1932 substantially reenacted the provisions of this joint resolution. The joint resolution was interpreted in 1938 as being only prospective in its operation so as not to apply the transfers made prior to the date of its adoption. *Hassett* v. *Welch* (303 U. S. 303).

In the face of what had long been regarded as the settled interpretation of the then existing estate-tax provisions relating to these pre-1931 transfers with retention of a life estate by the transferor, the Supreme Court in 1949 in effect overruled its two earlier decisions and held that a transfer of property in 1924, with income retained for life by the transferor, required that the transferred property be included in the taxable estate of the transferor who died in 1939. *Commissioner* v. *Church* (335 U. S. 632).

Following the Church decision the Technical Changes Act of 1949 (as amended) provided that, in the case of life estates retained in transfers made on or before March 3, 1931 (and in some cases before June 7, 1932), the property would not be included in the decedent's gross estate solely by reason of retention of the life estate if the decedent died after the enactment of the code on February 10, 1939, and prior to January 1, 1951. As that act was passed by the Senate, it contained provisions which would have restored the estate-tax law to what it was prior to the Church opinion, that is, pre-1931 transfers would not be included in the gross estate of the decedent merely by reason of the retention of a life estate, regardless of when the decedent died. This provision was limited in conference, however, in the manner described above.

It is believed that the effect of the Church decision should be eliminated in all cases to which it was applicable. Prior legislation has already restored the estate-tax law to what it was before the Church decision in respect to all decedents dying after the enactment of the code and prior to January 1, 1951. The provision in the bill accomplishes this same result in respect of decedents dying on or after January 1, 1951.

The bill also provides relief for certain decedents where the death occurred prior to February 11, 1939, and whose estates were burdened with estate tax by reason of transfers made before March 4, 1931, involving the retention of a life estate, the reservation of a minute reversionary interest, or both. Since property transferred in this manner would not be included in the gross estate if the decedent died after February 10, 1939 (and before 1951), the bill would achieve a similar exemption for estates of decedents dying prior thereto. However, it is not felt necessary to open the statute of limitations to any great extent in cases of decedents dying prior to February 11, 1939. It is only in cases in litigation at the time of the Church decision where there would appear to be any undue hardship. In these cases a refund or credit resulting from this provision will be allowed if a claim is filed within 1 year from the date of enactment of this act.

*Section 208. Failure to relinquish a power in certain disability cases*

Grantors of discretionary trusts created prior to January 1, 1939, who had retained certain powers which would result in the inclusion of the trust property in their gross estate for estate tax purposes were,

under section 1000 (e) of the code, permitted to relinquish such powers on or after January 1, 1940, and on or before December 31, 1947, free of gift tax. Grantors who were unable to relinquish their discretionary powers within the above period because of a mental disability should not be penalized. It is therefore provided that there shall not be included in a decedent's estate property previously transferred in trust as to which he retained certain discretionary powers if such decedent for at least 3 months prior to December 31, 1947, and continuing to the date of his death was under a mental disability such that he could not have relinquished such powers free of gift tax pursuant to section 1000 (e). The term "mental disability" is intended to encompass those cases in which the decedent during the requisite period prior to his death was, in fact, incapable because of his mental condition of relinquishing the power, whether or not he was legally declared mentally incompetent during all or any part of such period.

*Section 209. Reversionary interests in case of life insurance*

Section 404 (c) of the Revenue Act of 1942 (as amended by sec. 503 (a) of the Revenue Act of 1950) provided in the case of decedents dying after the date of its enactment (October 21, 1942) that the proceeds of life insurance policies should not be included in the decedent's estate by reason of premiums paid by the decedent prior to January 10, 1941, if the decedent at no time after that date retained an incident of ownership in such policy. In determining whether the decedent had such an "incident of ownership" after January 10, 1941, there was to be taken into account only those reversionary interests exceeding 5 percent of the value of the policy and arising other than by operation of law. It is believed that similar treatment should be extended in the case of decedents dying after January 10, 1941, and before October 22, 1942. Such decedents will be deemed to have an incident of ownership in insurance policies by reason of a reversionary interest held after January 10, 1941, only if such reversionary interest exceeded 5 percent of the value of the policy and arose by the express terms of the policy or other instrument and not by operation of law.

*Section 210. Marital deduction in certain cases where decedent died before April 3, 1948*

The provisions of this section relate to the marital deduction for estate-tax purposes. Attention has been called to certain situations where a decedent died after December 31, 1947, but prior to the date of the enactment of the Revenue Act of 1948, which allowed a marital deduction for estate-tax purposes. Consequently, while the act applied to such cases, estates of decedents dying within this short period from January 1, 1948, to the date of its enactment on April 2, 1948, were unable to secure the benefit of its provisions in some cases because the will of the decedent was not in accord with certain technical requirements of the act. If the decedent had been alive after the enactment of the Revenue Act of 1948, his will would undoubtedly have been rewritten to conform to the provisions of the act. Thus, under the act, property subject to a power of appointment in order to be taken into account for purposes of the marital deduction must meet the requirements of section 812 (e) (1) (F) of

the Internal Revenue Code. This section requires the interest in property passing from the decedent under a power of appointment to be in trust and the power to be unlimited and exercisable by the surviving spouse at all events. Cases have arisen where the power granted to the surviving spouse was not in trust and was confined to a power in the surviving spouse to use and consume such portion of the property as the surviving spouse may need or desire for her (or his) comfortable support or maintenance. In the case of a decedent dying after December 31, 1947, and prior to April 3, 1948, a power of this broad application should be considered as sufficient to permit the marital deduction of property subject to such power and the bill so provides. The section is only applicable if the surviving spouse files with the Secretary of the Treasury within 1 year after the date of the enactment of this act an election to take the benefits of the section. If such an election is made the property subject to such power shall be considered as property as to which the surviving spouse had a general power of appointment created on the date of the decedent's death, exercisable by deed or by will. Thus a reliquishment of such power by the surviving spouse during her lifetime will result in a taxable gift and if such power is not relinquished during the lifetime of the surviving spouse, the property subject to such power will be considered as part of the estate of such surviving spouse for estate-tax purposes.

*Section 211. Mitigation of effect of statute of limitations*

Section 3801 of the code allows either the taxpayer or the Commissioner to correct an improper tax result in certain cases where such action would otherwise be prevented by the running of the statute of limitations. This is possible by reason of the allowance under that section of an additional period of time beyond the period of limitations which would ordinarily be applicable. One of the principles of the present statute is to preclude any adjustment unless the hardship results from the maintenance of an inconsistent position by either the taxpayer or the Commissioner.

The statute operates effectively in cases to which it is directed, but tax inequities, the correction of which is prevented by the running of the period of limitations, may exist without regard to whether or not the position maintained by either party is inconsistent. A taxpayer may be disallowed a deduction or credit to which he is entitled in another taxable year or to which a related taxpayer may be entitled. Similarly, the Commissioner may have included an item in income for a taxable year different from the year for which such item should have been included, or the Commissioner may have included the item in the income of a related taxpayer.

Under present law, the errors described may not be corrected if discovered after the expiration of the period of limitation in respect to the correct year of the taxpayer or of the proper taxpayer. The bill includes provisions amending section 3801 in order to open the statute of limitations in such cases. Where a taxpayer claims a deduction or credit for a taxable year which is later determined to be the incorrect taxable year, or which is determined properly to belong to a related taxpayer, the amendment would permit a proper adjustment. However, the taxpayer is entitled to the benefits of this provision only if a credit or refund of the overpayment attributable

to the deduction or credit for the correct year or to the related taxpayer was not barred at the time the taxpayer formally asserted that he should have received such credit or refund in the year disallowed.

Similarly, the Commissioner would be allowed to make assessment of tax with respect to the proper taxable year, if at the time he formally asserted that an item was includible in income for a taxable year, later determined to be the incorrect year, he could have made a proper assessment of tax for the correct year. An opportunity to make a proper assessment would also be extended to the Commissioner under similar circumstances in the case of the related taxpayer.

The provisions added by the bill apply only where the determination relating to the disallowance of the deduction or credit, or the exclusion of the items from gross income, as the case may be, became final after June 30, 1952. Under your committee's bill the provision will not apply if the determination became final prior to June 1, 1952.

In the opinion of the committee it is necessary to dispense with requirements of subsection 4 of rule XXIX of the Standing Rules of the Senate to expedite the business of the Senate.