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AN ACT TO AMEND THE INTERNAL REVENUE CODES OF 1939 AND 1954, AND FOR OTHER PURPOSES

AUGUST 2 (legislative day, JULY 2), 1954.— ered to be printed

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

REPORT

[To accompany H. R. 6440]

The Committee on Finance, to whom was referred the bill (H. R. 6440) to amend section 345 of the Revenue Act of 1951, having considered the same, report thereon with amendments and recommend that the bill as amended do pass.

SECTION 1. AMENDMENT RELATING TO ABATEMENT OF TAX ON CERTAIN TRUSTS FOR MEMBERS OF THE ARMED FORCES DYING IN SERVICE

Section 345 of the Revenue Act of 1951 provided for a credit or refund of the tax on the income of trusts in cases in which the income had been accumulated for the benefit of servicemen who were killed on active duty on or after December 7, 1941, and before January 1, 1948. The 1951 legislation, however, failed to afford relief to cases where refunds were barred by reason of prior court adjudications, the expiration of the period of limitations, or other similar reasons. Your committee is of the opinion that this failure was largely an oversight, and it believes that treatment equivalent to that provided by section 345 of the Revenue Act of 1951 should likewise be extended to this area. Section 1 of the bill, which corresponds in substance to section 1 of the House bill, accordingly provides that if refund or credit of an overpayment resulting from the application of section 345 of the Revenue Act of 1951 is prevented on the date of the enactment of this act by the operation of any law or rule of law (other than the provisions relating to closing agreements and to compromises), refund or credit of such overpayment may, nevertheless, be made or allowed if a claim therefor is filed within 1 year after the date of enactment of this bill. No interest, however, shall be allowed or paid on any overpayment if a refund or credit of such overpayment would not be allowable but for this section.

Your committee has changed the form of the House bill to provide that the changes made therein will be an amendment to the internal revenue laws instead of an amendment specifically to section 345 of the Revenue Act of 1951. Certain other clarifying and technical changes in the language of the House bill have been made. The loss in revenue resulting from this amendment will be negligible.

SECTION 2. STOCK IN AFFILIATED CORPORATION

This section, for which there is no corresponding provision in the House bill, amends section 23 (g) (4) of the Internal Revenue Code of 1939 and is applicable to taxable years beginning after December 31, 1950, provided no notice of deficiency has been mailed to the taxpayer on or before the date of enactment of this bill.

The Internal Revenue Code of 1939 provides in general that if securities become worthless the taxpayer holding them realizes a capital loss. Such a loss on stock of affiliated corporations is an exception, however, and is treated as an ordinary loss. A corporation is deemed affiliated if 95 percent of each class of its stock is owned by the taxpayer and more than 90 percent of its gross income is from sources other than royalties, rents, dividends, interest, annuities, or gains from sales or exchanges of stock or securities. This section would substitute a receipts test for the income test, so that a decline in the gross profit margin (or a loss) will not reduce non-investment-type income to less than the required 90 percent. Such a result might prevail under the income test, since gross income is only arrived at after deduction of the cost of goods sold. It also provides that, for purposes of the receipts test, gross receipts from sales or exchanges of stocks and securities shall be taken into account only to the extent of gains therefrom. The same changes were also made in the Internal Revenue Code of 1954 (sec. 165 (g) (3)), applicable to taxable years beginning after December 31, 1953.

It is estimated that the revenue loss from this provision is negligible.

SECTION 3. RAILROAD CORPORATIONS SUBJECT TO RECEIVERSHIP OR BANKRUPTCY PROCEEDINGS

This section, for which there is no corresponding provision in the House bill, amends section 723 of the Internal Revenue Code of 1939 (relating to the computation of equity invested capital in special cases under the World War II excess-profits tax) to provide that, in the case of a recapitalization of a railroad corporation pursuant to receivership or bankruptcy proceedings, the equity invested capital is to be the same as if the corporate assets were transferred to a new corporation. Where the properties of a railroad corporation are transferred to a new corporate entity in receivership or bankruptcy proceedings, the equity invested capital is determined under section 760 of the World War II excess profits tax and reflects the basis of the transferred assets. The treatment thus provided in the case of a new corporation results from the addition of sections 112 (b) (9) and 113 (a) (20) to the 1939 code by section 143 of the Revenue Act of 1942.

The report of the Senate Finance Committee accompanying the Revenue Act of 1942 (S. Rept. No. 1631, 77th Cong., 2d sess.) indicates that the purpose of the committee was to provide equal treatment

whether a new corporation was organized, or the existing corporate entity was used, to effectuate the plan of reorganization. It has been brought to the attention of your committee, however, that, because of subsequent court decisions, some doubt exists that a recapitalization of an existing corporate entity in receivership or bankruptcy proceedings would be accorded as favorable treatment as where the assets are transferred to a new corporation. The adoption of this amendment thus carries out the expressed intent of the committee in connection with the changes affecting such reorganizations adopted in the Revenue Act of 1942.

Under the amendment, the equity invested capital of a railroad corporation which has been recapitalized after December 31, 1938, in pursuance of an order of the court having jurisdiction of such corporation, either in a receivership proceeding or in a proceeding under section 77 of the National Bankruptcy Act, will be determined in the same manner as if the assets which the corporation held immediately following the recapitalization had been transferred to a new corporation in a transaction to which section 760 of the Internal Revenue Code of 1939 is applicable. For this purpose, all of such assets are to be considered as having been transferred to a new corporation in exchange for the stock, securities, and other liabilities existing immediately after the recapitalization. The amendment is effective with respect to taxable years beginning after December 31, 1941.

It is estimated that the revenue effect of this provision will be negligible.

SECTION 4. PROFITS INURING TO THE BENEFIT OF ORGANIZATIONS EXEMPT FROM TAXATION UNDER SECTION 101 OF THE INTERNAL REVENUE CODE OF 1939

This section, for which there is no corresponding provision in the House bill, amends section 302 (d) of the Revenue Act of 1950, as added by section 601 of the Revenue Act of 1951. Subsection (d) was added to provide that certain feeder organizations, i. e., organizations operated for profit but the profits of which were dedicated exclusively to exempt purposes, would not be denied tax-exempt status under section 101 of the Internal Revenue Code of 1939 on the ground that they were carrying on a trade or business for profit.

It has come to the attention of your committee that in some cases "feeder" organizations whose profits inure to hospitals and institutions for rehabilitation of the physically handicapped, and which otherwise would qualify under subsection (d), have been denied exemption thereunder and under section 101 because of having been organized for profit. This section amends subsection (d) to make certain that its applicability to such "feeder" organizations will not depend on whether or not they were organized for profit.

This section also provides that the amendment shall be effective as if enacted as a part of section 601 of the Revenue Act of 1951. It is estimated that the revenue effect of this provision will be negligible.

SECTION 5. CHANGE IN EFFECTIVE DATE FOR FAILURE TO RELINQUISH A POWER IN CERTAIN DISABILITY CASES

This section, for which there is no corresponding provision in the House bill, amends section 208 (b) of the Technical Changes Act of

1953 by making that provision applicable to estates of decedents dying after December 31, 1947, instead of to estates of decedents dying after December 31, 1950, as provided in the Technical Changes Act.

Section 208 of the Technical Changes Act of 1953 permitted for estate tax purposes the tax free release of certain powers over a discretionary trust described in section 1000 (e) of the Internal Revenue Code of 1939, if the grantor was under a mental disability for a continuous period of not less than 3 months beginning before December 31, 1947, and ending with his death. The Technical Changes Act thus did not extend relief to a grantor under such a disability who died after December 31, 1947, and before January 1, 1951. This amendment would grant relief in such cases. The amendment is effective as if enacted as a part of section 208 (b) of the Technical Changes Act of 1953.

It is estimated that the revenue effect of this provision is negligible.

SECTION 6. EXCHANGE OF STOCK FOR PROPERTY OR SERVICES

This section, for which there is no corresponding provision in the House bill, amends section 1032 (a) of the Internal Revenue Code of 1954. The amendment is applicable to taxable years beginning after December 31, 1953, and ending after the date of the enactment of the 1954 code.

The amendment expressly provides that no gain or loss shall be recognized to a corporation upon the distribution by such corporation of its own stock (including treasury stock) as compensation for services rendered. It is estimated that the revenue effect of this provision is negligible.

SECTION 7. LIVESTOCK SOLD ON ACCOUNT OF DROUGHT

This section, for which there is no corresponding provision in the House bill, adds a new subsection (f) to section 1033 of the Internal Revenue Code of 1954. Such subsection (f) provides that the sale of livestock (other than poultry) held by a taxpayer for draft, breeding, or dairy purposes is to be treated as an involuntary conversion within the meaning of section 1033 of the 1954 code if certain conditions are met. First, such livestock which are held for draft, breeding, or dairy purposes must be located in an area in respect of which the President determines under the act of September 30, 1950 (Public Law 875, 81st Cong.), as amended, that a major disaster exists because of drought. Although the livestock must be held in such area prior to sale, your committee does not intend by this condition to prevent a taxpayer from shipping his livestock out of the area solely for purposes of effectuating a sale. Second, the sale of such livestock, regardless of whether made before or after the President's determination, must have been made solely on account of the drought to which such determination relates.

The general provisions of section 1033 which are applicable to involuntary conversions of property will likewise be applicable to conversions of livestock which occur either because of disease or because of drought. Thus, a taxpayer who suffers an involuntary conversion of livestock would be allowed, under subsections (e) and (f) of section 1033, the 1-year period provided in subsection (a) (3) (B) in which to

make a replacement of such livestock. If, however, conditions at the expiration of this replacement period make replacement impracticable, the taxpayer may make an application to the Secretary or his delegate under subsection (a) (3) (B) (ii) for an extension of the replacement period. Similarly, the requirement of subsection (a) (3) (A), relating to the replacement of converted property with property "similar or related in service or use to the property so converted," is applicable to involuntary conversions of livestock. As presently interpreted by the courts, this test requires that the new property be functionally the same as the old. (See *Lynchburg National Bank and Trust Co.*, 20 TC 670, aff'd 208 F. (2d) 757.) Accordingly, the taxpayer who sustains an involuntary conversion of livestock must not only replace such livestock with livestock of a like kind (for example, horses with horses or hogs with hogs), but he must also hold the new livestock for the same useful purpose as he held the old. Thus, although dairy cows could be replaced by dairy cows, a taxpayer could not replace draft animals with breeding or dairy animals.

It is estimated that the revenue effect of this provision is negligible.

SECTION 8. RADIO AND TELEVISION RECEIVING SETS AND COMPONENT PARTS

This section, which was added by your committee, provides that the 10 percent excise tax on radios, television sets, phonographs, automobile radio or television sets, and combination radio, television or phonograph sets, is to apply only if the article is of the entertainment type. It also limits to cabinets and tubes, the radio and television components which are to be taxable when sold separately from a set. Under the amendment the following items are exempt from tax: chassis, speakers, amplifiers, power supply units, antennae of the built-in type and phonograph mechanisms. The definition of radio and television components has also been changed so as to tax components "for" taxable sets, in lieu of components "which are suitable for use on or in connection with, or as component parts of" taxable sets. The word "for" in this case is to be interpreted in the same manner as in the case of the excise tax on automobile parts and accessories, where it has been interpreted as taxing parts and accessories the primary use of which is in taxable motor vehicles. The above changes also make it possible to remove several provisions in present law relating to the special exemption for communication, detection and navigation receivers when sold to the United States Government, as these receivers will in any case be exempt under the new provisions since they are not "of the entertainment type." This exemption, however, is preserved for any article with respect to which the tax is paid under section 3404 (a) or (b) of the Internal Revenue Code of 1939 as in effect prior to the effective date of the amendments to such section. Therefore, any manufacturer, producer, or importer who has sold a receiver to the United States may still claim a credit or refund for the tax paid under section 3404 (a) or (b) for any article incorporated in such receiver.

This excise tax has been limited to items of the entertainment type because your committee sees no reason for singling out special communication and navigation equipment used by businesses for special excise-tax levies. This is in conformance with similar actions taken

by Congress in recent years in revising the tax bases of the excise taxes on photographic apparatus and film and electric, gas and oil appliances. Moreover, this change and the narrowing of taxable components to cabinets and tubes will considerably ease administrative and compliance problems under this tax. The revenue loss of the provisions in a full year of operation is estimated at $2 million.

This section is to be effective the first day of the first month beginning more than 10 days after the date of enactment of this bill. This effective date makes it necessary to amend both the 1939 code and the 1954 code since the excise provisions in the latter are not effective until January 1, 1955. The sections of the 1939 code which are amended are sections 3404 (a) and (b), 3443 (a) (1) (B) and (3) (A) (vi), and 3444 (b). The sections of the 1954 code which are amended are sections 4141, 4142, 4143, 4218 (b), and 6416 (b) (2) (G) and (3) (B).

SECTION 9. UHF TELEVISION RECEIVING SETS

This section, which was added by your committee, allows a $7 credit against the 10-percent excise tax on television receiving sets (or automobile television receiving sets or combinations of television sets with radios or phonographs) where the television set is capable of receiving all ultra high frequency channels. However, the credit allowable is not to exceed the tax otherwise payable on the television receiving set. Where the television unit is a part of a combination with a taxable radio or phonograph, the credit will apply only against the portion of the tax properly allocable to the television unit.

The credit provided by this section is to be available only if the television set when sold by the manufacturer, producer or importer is equipped with an all-channel UHF tuner as distinguished from the so-called strip tuners capable of receiving only certain of the UHF channels. The classification as to what constitute ultra high frequency channels will be determined by regulations so as to provide the same classification as is used by the Federal Communications Commission.

Your committee has adopted this provision because it believes it is desirable to encourage manufacturers of television sets to provide for UHF channel reception. The sale of sets with all-channel UHF tuners is essential to the establishment of new UHF stations in areas not now adequately serviced by VHF television stations. It is also important to the development of UHF stations in areas already having some VHF stations. It is estimated that this provision will reduce Federal revenues in a full year of operations by approximately $25 million.

This provision is effective with respect to sales occurring on and after July 26, 1954. This requires the amendment of both the 1939 code and the 1954 code, since the excise tax provisions in the latter are not effective until January 1, 1955. The amendment to the 1939 code is to section 3404 (a) and the amendment to the 1954 code adds a new section 4144.

SECTION 10. CUTTING OILS

This section, which was added by your committee, revises the manufacturers' excise tax with respect to cutting oils. Prior to the Excise Tax Reduction Act of 1954 such oils were classified as lubricating oils and taxed at a rate of 6 cents a gallon. The Excise Tax Reduction

Act continued the 6 cents a gallon tax on lubricating oils in general, but provided that the tax on oils known as cutting oils was not to exceed 10 percent of the manufacturers' sales price. This section deletes the provision limiting the tax on cutting oils to 10 percent of the manufacturers' price and substitutes a flat tax of 3 cents a gallon for cutting oils.

The tax of 3 cents per gallon will average about 10 percent of the manufacturers' price for cutting oils. The specific gallonage tax, rather than an ad valorem price tax, is preferred in the case of cutting and other lubricating oils because the industry is accustomed to this type of tax and because this provides a uniform tax irrespective of whether the manufacturer sells at the wholesale or retail level. It is estimated that the revenue loss from this provision will be negligible.

This provision is effective with respect to sales occurring on the first day of the first month which begins more than 10 days after the date of enactment of this bill. This makes it necessary to amend both the 1939 code and the 1954 code, since the excise provisions in the latter are not effective until January 1, 1955. In the 1939 code the amendment is made to section 3413. In the 1954 code amendments are made to sections 4091 and 4092.

SECTION 11. LEASES OF CERTAIN AUTOMOBILE UTILITY TRAILERS

This section, which was added by your committee, deals with the taxation of leases of certain automobile utility trailers. Under present law where manufacturers lease, instead of sell, articles subject to a manufacturers' excise tax, the manufacturers' tax applies to each lease payment. This provision provides that in the case of certain automobile trailers or semitrailers the maximum tax which is to be collected in the case of such leases is an amount equal to the applicable tax rate times the fair market price for which the manufacturer could sell the trailer at the time of the first lease of the trailer. At the option of the taxpayer the tax may be paid in full at the time of the first lease or spread over the lease payments. If the taxpayer selects the latter option, the tax he pays on each payment is to be equal to the applicable rate times the amount of each lease payment, until the total amount collected in this manner equals the maximum tax described above. Thereafter the lease payments are free of tax.

If the trailer is sold after having been leased for a while (but not long enough for the payment of the full tax) the remaining tax payable at the time of the sale is the difference between the tax already paid and the applicable rate times the smaller of two amounts: (1) the fair market price at the time of the initial lease, or (2) the sales price plus lease payments previously received. This section also provides for leases entered into before the date of enactment of this bill which are still in effect after that date. In such a case the section provides in effect that the lease is to be considered as a new lease as of that date and that taxes paid on prior lease payments are to be ignored in applying this section. If no lease is in effect on such date, the taxpayer may consider the first lease made after that date as the initial lease.

The type of trailer which is to receive the treatment with respect to lease payments described above is a trailer or semitrailer suitable for use in connection with passenger automobiles whether the trailer

is subject to the 8-percent tax on trucks or the 10-percent tax on passenger automobiles.

Your committee believes that this amendment is desirable because at the present time manufacturers of these utility trailers who also maintain a rental business are discriminated against, relative to businesses which carry on either, but not both, of these activities. Frequently the sum of the rental payments received on a utility trailer substantially exceeds the price which a manufacturer would charge for such a trailer, since each such charge includes not only a pro rata portion of the cost of the trailer but also a share of the expenses of maintaining the rental business as well. It is estimated that revenue loss in this provision will be negligible.

This provision is effective on the first day of the first month which begins more than 10 days after the date of enactment of this bill. This requires amendments to both the 1939 code and the 1954 code, since the excise provisions in the latter are not effective until January 1, 1955. The sections of the 1939 code which are amended are sections 3441 (c) and 3440. In the 1954 code, amendments are made to sections 4216 and 4217.

SECTION 12. SALES OF CERTAIN TAXABLE COMPONENT PARTS FOR USE IN OTHER MANUFACTURED ARTICLES

This section, which was added by your committee, provides that parts, accessories or components subject to manufacturers' excise taxes may be sold free of tax (or a refund or credit provided to the vendee where not so sold) if the vendee uses, or resells, them "as material in the manufacture or production of, or as a component part of" other articles, whether or not the other articles are subject to a manufacturers' excise tax. Parts, accessories or components presently subject to manufacturers' excise tax are automotive parts or accessories, refrigeration components, radio or television components, and camera lenses. Presently most of these parts or components are taxable if sold to a manufacturer for incorporation in an article not subject to a manufacturers' excise tax, or if sold for resale to such a manufacturer. This is true of radio and television components and camera lenses. Refrigerator components, however, are not taxable if sold for incorporation in, or as components of, refrigeration equipment whether or not such equipment is subject to manufacturers' excise tax. (This provision is eliminated by this bill as no longer necessary.) Under a ruling of the Internal Revenue Service issued in 1932, automotive parts and accessories (other than spark plugs, storage batteries, leaf springs, coils, timers, and tire chains), may be sold free of tax by one manufacturer to another manufacturer even though they are to be used in the manufacture of nontaxable articles. On the other hand, if such parts and accessories are sold taxpaid, no credit or refund may be claimed if they are used in the manufacture of nontaxable articles.

The adoption of a single rule for these parts or components exempting them from tax where they are sold for incorporation in other end articles, whether or not the end articles are taxable, will result in a uniform application of these taxes and thereby provide greater equity and simplify administration and compliance. Providing for tax-free sales where the end products are not taxable also will prevent the in-

direct taxation of articles which Congress has not deemed it desirable to subject to direct excise taxation. Furthermore, where there are substitute components for these end articles which are not subject to tax, this removes the discrimination against the manufacturers of the taxable parts or components. Moreover, this will remove the indirect tax paid by States and municipalities, or with respect to articles produced for export, where these parts or components are purchased by manufacturers for incorporation in other articles. It is believed that the effect of this provision on revenues will be negligible.

This provision is to be effective the first day of the first month which begins more than 10 days after the date of enactment of this bill. This makes it necessary to amend both the 1939 code and the 1954 code since the excise tax provisions in the latter are not effective until January 1, 1955. The sections of the 1939 code which are amended are sections 3442, 3443 (a) (1), 3444, 3403 (c), and 3405 (b). The sections of the 1954 code which are amended are sections 4218, 4220, 4113, 4112, 4063 (c), and 6416 (b) (3).

SECTION 13. EXEMPTION OF CERTAIN RODEOS AND LIVESTOCK SHOWS FROM ADMISSIONS TAX

This section, which was added by your committee, amends the 10 percent excise tax on admissions to provide an exemption for admissions to certain rodeos and livestock shows. The Internal Revenue Code of 1954 contains an exemption for admissions to rodeos (and historical pageants) where (1) the proceeds are used exclusively for the improvement, maintenance or operation of the rodeo, and (2) no part of the net earnings inures to the benefit of any private stockholder or individual. This section adds an exemption for rodeos where the second of these two conditions is met and where the proceeds are used by a nonprofit organization for the furnishing of premiums to exhibitors (at the rodeo or at a livestock show where admissions are free of tax), the establishment of student scholarships or charitable purposes. An exemption is also provided for livestock shows subject to the same limitations.

Your committee believes this provision is desirable because it encourages the use of proceeds from rodeos for worthwhile public purposes. It also believes that the same treatment should be provided for livestock shows. It is estimated that this provision will have a negligible effect on revenues.

This provision is effective as if it had been enacted as a part of the Internal Revenue Code of 1954. Thus it becomes effective as of January 1, 1955, the general effective date of the excise provisions in the 1954 code. This section amends section 4233 (a) of the 1954 code by striking out paragraph (9) and inserting new paragraphs (9), (10), and (11).

CHANGES IN EXISTING LAW

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

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