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CERTAIN 1939 CODE BONDS AND REACQUISITIONS OF REAL PROPERTY

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

REPORT

[To accompany H.R. 4844]

The Committee on Finance, to whom was referred the bill (H.R. 4844) relating to the release of liability under bonds filed under section 44(d) of the Internal Revenue Code of 1939 with respect to certain installment obligations transmitted at death, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

I. SUMMARY

Your committee has accepted the House provision without change but has added an amendment relating to a different tax matter.

The provision in the House-passed bill which your committee has accepted without change provides that gain from installment obligations which were transferred to a taxpayer from a decedent in taxable years to which the 1939 Code applied (generally, years beginning before January 1, 1954), but with respect to which installment payments are still being made, may be reported by the recipient on a pro rata basis as he receives installment payments without the necessity of maintaining a bond with the Internal Revenue Service to assure this reporting of the income. Under the 1939 Code, the reporting of gain on installment obligations at the time of the death of a decedent could be avoided only by the person receiving the obligation electing to file a bond giving assurance that he would report the income on the installment obligation on a pro rata basis over the period the installment payments were received in the same manner as would the decedent had he continued to live and receive the payments. Essentially, this exception achieved the same result as the general rule under the 1954 Code, but required the filing of a bond. The effect of this provision is to continue this treatment but without the necessity of filing this bond. This result is achieved by applying the 1954 Code

rules in these cases (without any deduction for estate tax attributable to these obligations) at the election of the taxpayer. This applies with respect to payments received in taxable years where the due date for the filing of the returns (including extensions of time) will occur after the date of enactment of this bill.

Your committee has added an amendment to the bill providing that where real property is sold and the seller receives a mortgage or similar debt obligation on the real property, and then subsequently the seller is forced to repossess the property, any gain resulting from the repossession is to be limited to the money (and value of other property) received by the seller with respect to the sale before the repossession to the extent that such amounts have not already been reported as income. In the case of repossessions occurring after the enactment of this provision any gain recognized on repossession is further limited in that it may not in any event exceed the gain attributable to the initial sale. This provision also prevents loss in the case of these repossessions. Under present law, in the usual case where the gain has been reported on the installment basis, gain is recognized at the time of repossession to the full extent of the excess of the fair market value of the property repossessed over the basis of the installment obligation attributable to this property. The treatment provided in your committee's amendment applies on an elective basis to taxable years beginning after December 31, 1957, and is the only rule to be applicable in this area to years beginning after the date of enactment of this bill.

The Treasury Department has indicated that it has no objection to the House-passed provision of this bill. With respect to the amendment made by your committee, the Treasury has indicated that the substantive changes made by this provision represent a substantial improvement in our tax laws and that this amendment deserves favorable consideration. With regard to the effective date of this provision, the Treasury Department has indicated that it may well be concluded that the proposed provision should be given a limited retroactive effect, as in this bill. The Treasury has also stated that, if Congress were so to conclude, Treasury would not oppose this effective date.

II. CERTAIN BONDS FILED UNDER 1939 CODE PROVISIONS

Present law.—Under the Internal Revenue Code of 1939 (as under the 1954 Code) in the case of the sale of real estate and casual sales of personal property, installment sale contracts, where certain conditions are met, at the election of the taxpayer give rise to gain or loss over the period of time over which the installment payments are made: Any gain or loss in such a case generally is treated as being realized over the period of the installment payments in the same proportion as the ratio of the installment payments to the total payments under the contract. However, under the 1939 Code, if an installment obligation is "distributed, transmitted, sold, or otherwise disposed of," any remaining gain or loss not previously reported must be reported at that time.[1] An exception to this rule was provided under the 1939 Code, however, in the case of a transmission of property at the time

[1] The gain or loss to be reported in such a case is the difference between the basis of the obligation and the sale price or, in the case of a distribution, transmission, or disposition otherwise than by sale or exchange, the fair market value of the obligation at the time of the transfer.

of the death of a decedent, if there was filed with the Commissioner of Internal Revenue a bond to guarantee that the recipient of any payment on the installment obligation would report the obligation as income in the same proportion and in the same manner as would the decedent if he had continued to live and received the payment himself.

The 1954 Code in effect makes this exception under the 1939 Code the general rule but removes the bonding requirement. Thus, the 1954 Code includes in the category of "income in respect of decedents" (sec. 691) installment obligations transferred upon the death of a decedent where the decedent had previously made an earlier sale and taken in return an installment obligation upon which he was reporting the gain as he received the installment payments. Thus, the 1954 Code, like the exception under the 1939 Code, requires the reporting of the income on these installment obligations by the recipient of the payments at the same time and in the same manner as would the decedent had he continued to live and receive the installment payments. Under the 1954 Code, however, this is not an exception but rather the uniform rule. Therefore, under the 1954 Code, no bonding requirement was viewed as necessary in order to assure the reporting of these amounts as income.

In addition to deleting the bonding requirement, the 1954 Code rule also departs from the exception under the 1939 Code in that the recipient is allowed a deduction for any estate tax paid at the time of the death of the decedent, to the extent attributable to the inclusion in his gross estate of this installment income item. This deduction, of course, decreases the aggregate gain and, therefore, the proportion of each installment which must be reported as taxable gain. No comparable deduction is available under the 1939 Code exception, whether or not the election provided by this bill is exercised.

The Internal Revenue Service has held that the 1954 Code provisions relating to "income in respect of a decedent" and installment sales do not replace the 1939 Code provisions (including the one which provides for the reporting of gain on installment obligations by the transferee where a bond is received) in those cases where the transfer took place before the general effective date of the 1954 Code (taxable years beginning before January 1, 1954, and ending after August 16, 1954), but the installment payments in question are received after that date.[2] Thus, in some cases, the bonding requirements of the 1939 Code are still in effect; that is, in those cases where the decedent died in a 1939 Code year but the installment payments spread over a period of more than 10 years.

The Treasury Department reports that 2 years ago there were 22 of these bonds outstanding in the Los Angeles district and estimated that in the entire country there probably was somewhat less than 1,000 of these bonds outstanding.

Under the procedures established by the Internal Revenue Service, the amount of the bond which the individual must maintain to give the Internal Revenue Service assurance that the remaining income attributable to the installment obligation will be paid as the payments are received can be reduced from time to time. It can be reduced upon application of the holder of the obligation and a showing that

[2] Rev. Rul. 55-627 (C.B. 1955-2, 550) and Rev. Rul. 58-189 (C.B. 1958-1, 511).

the size of the bond needed is less, since the remaining income yet to be reported for tax purposes has been reduced.

Reasons for the provision.—There would appear to be no reason to continue the bonding requirements if the holders of these installment obligations which were acquired while the 1939 Code was still in effect are willing to enter into a binding agreement to have the 1954 Code rules, applicable to income in respect of decedents, apply (but as indicated later, without the deduction for estate tax). The effect of this is to continue the same tax treatment as was already applicable with respect to payments on these installment obligations, but without the necessity of the taxpayer providing a bond. From the standpoint of the taxpayer, this is desirable because he saves the premiums which he presently must pay to maintain these bonds. He also is saved the bother of applying for a reduction in the bond from time to time as installment payments reduce the size of the gain still to be reported fro tax purposes. From the standpoint of the Internal Revenue Service, the removal of the bonding requirement also is desirable because this removes the necessity of handling the administration of these bonds. Nor does the bonding appear necessary as a means of protecting the revenues since in a much wider area; namely, those cases where the installment obligations were acquired since the enactment of the 1954 Code, the recipient of the payments is taxed on the income involved without the bonding being considered as necessary.

General explanation of the bill.—This provision adds a new subsection to the 1954 Code (sec. 691(e)) which provides that the installment sales rule under the 1954 Code with respect to one of these obligations received from a decedent may, at the election of the taxpayer, apply in lieu of the 1939 Code provision in those cases where gain was not reported at the time of the decedent's death but rather a bond was filed assuring that the recipient of the obligation would report the gain on a pro rata basis as the payments on the installment obligation were received. Where this election is made, the provision specifies, however, that the deduction available under the 1954 Code in the case of income received from decedents for the estate tax attributable to these income items is not to apply to these installment obligations which, until this time, were still governed by the 1939 Code rules.

A taxpayer may elect to apply the rule provided under this provision by making an election to do so beginning with the first taxable year for which the time prescribed by law (including extensions of time) for the filing of the tax return has not yet expired. The election is to be made in the manner prescribed by the Treasury Department in its regulations. The election will apply to payments received on installment obligation in years to which the election applies.

The provision also authorizes the release of any bond required under the 1939 Code provision (sec. 44(d) of that Code) in any case where an election has been made under the new subsection provided by this bill (sec. 691(e) of the 1954 Code).

Effective date.—This provision generally becomes effective after the date of enactment of this bill. The provision, therefore, will apply with respect to payments received in any year with respect to which the time prescribed by law (including extensions of time) for the filing of the tax return for that year has not yet expired.

Revenue effect.—The Treasury Department has informed your committee that the enactment of this provision will have no effect

upon revenues, other than a saving in administrative costs for the Internal Revenue Service.

III. REPOSSESSIONS OF REAL PROPERTY

For taxpayers reporting gain on the installment basis, present law (sec. 453), provides that where real property is sold, but subsequently the seller is forced to repossess the property, gain is recognized by him at the time of repossession to the extent of any excess of the fair market value of the property at that time over the basis of installment obligations related to the property. Thus, in effect, under present law, the repossession is treated as a taxable exchange in which the original seller receives back the property in exchange for the installment obligations attributable to the property which he gives up. This "exchange" at the time of repossession can result either in the recognition of gain, or the recognition of loss, depending upon the fair market value of the property at that time.

This rule for determining gain or loss on repossession of real property which is applied for those on the installment basis is also applied under existing law in the case of sales not eligible for installment treatment because the payments received in the year of sale exceed 30 percent of the selling price of the property, and also in any case where the seller does not elect the installment method and the obligations of the purchaser have a fair market value. However, in the case of a sale where the obligation received by the seller is held not to have a determinable fair market value—known as a deferred payment sale—where title to the property is not transferred to the buyer (and the seller does not elect to report the sale on the installment basis under sec. 453), different treatment is provided on repossession. Gain at that time under present law is measured by the amount of money the seller received before the repossession plus the fair market value of fixed improvements placed upon the property by the purchaser.

Your committee believes that it is inappropriate to measure gain upon repossession by reference to the fair market value of the repossessed property. Your committee does not believe that merely because property originally held by a seller has been restored to him should constitute grounds for taxing any appreciation in value of this property to the seller at that time. Apart from any payments he may have received, he actually is in no better position than he was before he made the sale. As a result, your committee has concluded that instead of the repossession of the property being treated as a second sale of the property back to its original holder, it is desirable to consider instead that the first sale has been nullified.

In addition to the inappropriateness of considering the repossession to be a second sale or exchange, to do so also requires a determination of the fair market value of the property at that time. This frequently is difficult to determine because the "fair market value" is likely to vary according to whether the value of the property is determined on the basis of its value to the developer or other seller, or whether it is viewed on the basis of value to an individual buyer making a purchase for personal use. Your committee also noted that to tax the original seller on the basis of the current market value of the property may well require him to pay taxes with respect to gain where he has not yet received any specific monetary return. As a result, to tax him on this

appreciation may well present problems to the initial seller in obtaining the funds to pay these taxes.

Your committee also believes that it is desirable to have a uniform rule applicable in the case of repossession of real property, whether the initial sale was at a gain or loss, and if at a gain, without regard to the method of reporting the gain. In addition, your committee believes that it is desirable to have the same rule applicable whether the value of the property after the initial sale has gone up or down. As a result, the rule set forth below not only limits the gain to the payments received before repossession in the case of real property but also denies the recognition of any loss in the case of repossession of real property.

It should also be recognized that limiting the gain upon repossession to the payments actually received in the general case where the value of the property has not declined will not mean any decrease in ultimate taxpayments for the initial seller. Instead, it will only mean that any gain attributable to this property will be reported by him for tax purposes when he resells the property. To tax him on gain sooner than this in reality is taxing him on gain not yet realized. Moreover, where the value of the property has gone down since the time of the original sale, to tax him on such gain is to tax him not only on gain not realized to date but also on gain which may never be realized.

In view of the considerations set forth above, your committee has added a new section to the Internal Revenue Code of 1954 (sec. 1038) dealing with the reacquisitions of real property. The new provision specifies that where real property is sold and the seller accepts indebtedness secured by the real property in return, then if the seller repossesses the property, no gain or loss is to be recognized to the seller as a result of the repossession of the property except to a limited extent. The only gain to be recognized upon the repossession of the property is to be the amount of money (and fair market value of any property other than the debt of the purchaser) received as payments on the property before the repossession to the extent that these amounts have not previously been reported as income.[1] Moreover, in no event is the gain attributable to the payments received before repossession to exceed the potential gain attributable to the initial sale reduced by amounts received before repossession already reported as income and also reduced for expenses incurred by the seller in connection with the repossession of the property. This limitation on the gain on repossession to the potential gain on the initial sale will not apply, however, to repossessions in past years if the taxpayer elects to have the new provision applied retroactively.

The requirement referred to above that the indebtedness must be secured by the real property is to be considered as met where the title to the property is retained in the seller and is to go over to the purchaser only upon the completion of payments.

The basis of the repossessed property is to be the adjusted basis to the seller of the debt secured by the real property (determined at the time of the repossession) increased by any gain recognized at the time of the repossession and also for any expenses incurred by the seller in obtaining repossession. This should give assurance that the initial seller upon resale of the property will report any gain not previously reported, to the extent reflected in the current market value of the property. If the indebtedness to the seller is not discharged as a

[1] Gain may also result from the restoration of deductions taken before repossession where the debt was considered worthless or partially worthless.

result of the repossession of the property, the new provision specifies that the basis of this indebtedness is to be zero, so that any amount realized with respect to it will result in income and no loss may be realized if the obligations subsequently become worthless.

Your committee's bill also provides that if a seller, prior to the repossession, has treated indebtedness secured by the property as having become worthless or partially worthless, he is to be considered as having received upon the repossession of the property an amount equal to that which he treated as having become worthless. This treatment is accorded because losses are not to be recognized to the seller of the property upon repossession. Should the property, after the initial sale, go down in value and then be repossessed, any unrealized loss in the property may be subsequently realized upon resale of the property by the initial seller.

A special rule is provided for repossessions where the initial sale is that of the taxpayer's principal residence and the taxpayer has not recognized the gain (or part of the gain) either because he has obtained a second residence within a specified time (sec. 1034) or because he is over age 65 (sec. 121). In such cases where the taxpayer resells the property within 1 year after the repossession, no gain results at the time of repossession and the initial sale and resale are treated as one transaction where the gain ordinarily would be limited because a second residence has been purchased or no gain would be recognized because the taxpayer is over age 65. This treatment in effect ignores the repossession in these cases where the residence is again sold in a reasonable time.

Since the code already contains a special provision relating to repossessions in the case of domestic building and loan associations (described in sec. 593(a)), this provision is made inapplicable to them.

The provision outlined above is to apply in the case of all repossessions of real property in the taxable years beginning after the date of enactment of this bill. However, at the election of the taxpayer, this treatment also is to apply with respect to repossession of real property in taxable years beginning after December 31, 1957, except for those years closed by the statute of limitations on the date of enactment of the bill. An election to have this provision apply with respect to any of these past years can be made within 1 year after the date of enactment of this bill.

Refund or credit of overpayments of tax attributable to making the election provided in this provision is to be allowed if claim is filed within 1 year after the date of the election if the period for filing the claim for credit or refund of the overpayment is not prevented by any law or rule of law on the date of enactment of the bill. Similarly, deficiencies attributable to this provision may be assessed at any time before the expiration of 1 year after the date of the election if not prevented on the date of the election by any law or rule of law. No interest is to be paid on refund or credit before the date of enactment of the bill and no interest charged on deficiencies before that date which are attributable to this provision.

This provision has been made applicable to years beginning after December 31, 1957, on an elective basis because it is understood that many taxpayers would find it impossible to continue in business were the new provision not to be made applicable to their past operations because of the substantial number of repossessions which they have had. In the past, these taxpayers uniformly concluded that

they had no substantial gains on repossessions of the real property because the fair market value of the property repossessed was not greater than their basis in the installment obligation of the purchaser. However, it is understood that the Internal Revenue Service probably would view the fair market value of the real property in such cases as being more nearly equal to the much higher price at which the property was originally sold rather than the basis of the installment obligation. Should the probable view ofthe Internal Revenue Service prevail, it is likely that the deficiencies, if collected, would put many of these taxpayers out of business. In addition, it is clear that in such cases, there would of necessity be extensive litigation if this provision were not applied for this past period. Moreover, the application of this provision to the past period will not result in any appreciable permanent revenue loss but rather only a postponement of the revenue until such time as the taxpayers resell the repossessed property.

IV. TECHNICAL EXPLANATION OF REACQUISITIONS OF REAL PROPERTY

(a) Section 2 (a) of the bill adds a new section 1038 to the 1954 Code (relating to certain reacquisitions of real property). Under existing law, if the seller reacquires real property previously sold in partial or full satisfaction of any indebtedness arising from the sale, gain or loss may be realized, depending on the type of sale, and, in addition, the seller may have a bad debt deduction. In general, section 1038 limits the amount of gain and provides that there shall be no loss, as well as preventing deductions for bad debts, in such cases.

SECTION 1038. CERTAIN REACQUISITIONS OF REAL PROPERTY

(*a*) *General rule.*—Section 1038 is applicable to a sale of real property when such sale gives rise to indebtedness to the seller which is secured by the real property, and the seller of such property reacquires such property in partial or full satisfaction of such indebtedness. Since section 1038 applies to any case in which these two conditions are met, it is immaterial whether the seller realized a gain or sustained a loss on the sale of the real property (or even whether it can be ascertained at the time of sale whether there is a gain or a loss) or whether the seller is using the installment method of reporting the gain or reported all the gain or loss in the year of sale. A sale ordinarily has occurred even if title has not passed to the purchaser, if the purchaser has a contractual right to retain possession of such property so long as he performs his obligation under such contract, and to obtain title to such property upon completion of such contract. A sale may give rise to an indebtedness to the seller although the seller is limited in his recourse to the real property for payment of the indebtedness in the case of a default. An indebtedness is secured by real property for the purposes of subsection (a), for example, whenever the seller has right to take title or possession or both in the event that the purchaser defaults in his obligation under the contract. Since section 1038 is applicable only where seller reacquires the property in satisfaction of the purchaser's indebtedness, section 1038 generally would not be applicable where the seller repurchases the property by paying the buyer consideration in addition to the discharge of the indebtedness unless

such repurchase and payment of such consideration was provided for in the original contract for the sale of the property. However, section 1038 generally would be applicable if the seller reacquires the property when the purchaser has defaulted on his obligation, or his default is imminent, even if the seller pays additional consideration.

(*b*) *Amount of gain resulting.*—Subsection (b)(1) of section 1038 provides that in a case to which subsection (a) applies, gain shall result to the extent that (*a*) the amount of money and the fair market value of other property (other than obligations of the purchaser) received, prior to and upon such reacquisition, with respect to the sale of such property, exceeds (*b*) the amount of the gain on such sale returned as income for periods (including any portion of the taxable year of reacquisition) prior to such reacquisition. All payments with respect to the sale made by the purchaser at the time of the reacquisition shall be treated as having been made prior to such reacquisition. Amounts of money received by the seller include all payments made by the purchaser for the seller's benefit, as well as payments made directly to the seller. In the case of a reacquisition occurring beginning after the date of the enactment of this section, subsection (b)(2) provides that the amount of gain upon such reacquisition shall not exceed the amount by which the price at which the real property was sold exceeded its adjusted basis, reduced by the sum of (*a*) the amount of the gain on the sale of such property and returned as income for periods prior to the reacquisition of such property and (*b*) the amount of money and fair market value of property (other than obligations of the purchaser received with respect to the sale of such property) paid or transferred by the seller in connection with the reacquisition of such property. The limitation provided by subsection (b)(2) does not apply in a case where the selling price of property cannot be ascertained at the time of sale, as, for example, where the selling price is stated as a percentage of the profits to be realized from the development of the property sold. The price at which real property is sold is the gross sales price reduced by the selling commissions, legal fees, and other expenses incident to the sale of such property which are properly taken into account in determining gain or loss on such sale. Thus, for example, the amount of commissions paid by a dealer on the sale of real estate which are not deducted as a business expense reduces the gross sales price. Subsection (b) sets forth the extent to which gain shall result on a reacquisition, but it does not change the type of income which results. Thus, for example, gain by dealers in real estate as determined under this section will be ordinary income. Subsection (b)(3) provides that, except in cases to which subsections (e) and (f) apply, the gain determined under subsection (b) resulting from a reacquisition to which subsection (a) applies shall be recognized notwithstanding any other provision of subtitle A of the Internal Revenue Code. The gain determined under subsection (b), however, does not include amounts of interest provided for by the parties or determined under section 483 (relating to interest on certain deferred payments).

(*c*) *Basis of reacquired real property.*—Subsection (c) of section 1038 provides that the basis of any real property reacquired in a transaction to which subsection (a) applies shall be the adjusted basis of the indebtedness to the seller secured by such real property (determined as of the date of reacquisition, including any amount determined under subsec. (d)(2)), increased by the sum of the amount of gain determined

under subsection (b) and the amount described in subsection (b)(2)(B) (whether or not the limitation of subsec. (b)(2) is applicable). To the extent that any indebtedness to the seller secured by such real property is not discharged upon the reacquisition of such real property, the basis of such indebtedness shall be zero. This rule applies to indebtedness on the original obligation of the purchaser, a substituted obligation of the purchaser, a deficiency judgment entered in a court of law into which the purchaser's obligation has merged, and any other obligation arising from the transaction.

(*d*) *Indebtedness treated as worthless prior to reacquisition.*—Subsection (d) of section 1038 covers cases where, prior to a reacquisition of real property, the seller has treated indebtedness secured by such property as becoming worthless or partially worthless. In such cases, in addition to any gain determined under subsection (b), the seller shall be considered as receiving upon the reacquisition of such property, an amount equal to the amount of such indebtedness previously treated by him as having become worthless; and the adjusted basis of such indebtedness shall be increased (as of the date of reacquisition) by an amount equal to the amount so considered as received by such seller.

(*e*) *Principal residences.*—Subsection (e) of section 1038 provides treatment for the reacquisition of real property with respect to the sale of which (*a*) an election under section 121 (relating to gain from sale or exchange of residence of an individual who has attained age 65) is in effect, or (*b*) gain was not recognized under section 1034 (relating to sale or exchange of residence). If within 1 year after the date of the reacquisition of such property by the seller, such property is resold by him, then, under regulations prescribed by the Secretary or his delegate, subsections (b), (c), and (d) of section 1038 shall not apply to the reacquisition of such property and, for purposes of applying sections 121 and 1034, the resale shall be treated, under regulations prescribed by the Secretary or his delegate, as a part of the transaction constituting the original sale of such property.

(*f*) *Reacquisitions by domestic building and loan associations.*—Subsection (f) of section 1038 provides that this section shall not apply to a reacquisition of real property by an organization described in section 593(a) (relating to domestic building and loan associations, etc.).

SECTION 1038. NONRECOGNITION OF GAIN OR LOSS ON CERTAIN REACQUISITIONS OF REAL PROPERTY (CONTINUED)

(*b*) Subsection (b) of section 2 contains a clerical amendment.

(*c*) Subsection (c)(1) of section 2 provides that the amendments made by section 2 shall apply to taxable years beginning after the date of the enactment of this bill. However, subsection (c)(2) provides that if the taxpayer makes an election under such subsection, the amendments made by section 2 (other than subsection (b)(2) of the new section 1038 of the code) shall also apply to taxable years beginning after December 31, 1957, except that such amendments shall not apply with respect to any reacquisition in a taxable year if the assessment of a deficiency, or the credit or refund of an overpayment, for such taxable year is prevented by the operation of any law or rule of law on the date of enactment of the bill. Such an election must be made within 1 year after the date of the enactment of this bill

and shall be made in such form and manner as the Secretary of the Treasury or his delegate shall prescribe by regulations. Subsection (c)(3) provides that if an election is made by the taxpayer and if the assessment of deficiency, or the credit or refund of an overpayment of tax, for any taxable year to which such election applies is not prevented on the date of the enactment of this bill by the operation of any law or rule of law, the period within which a deficiency for such taxable year may be assessed (to the extent such deficiency is attributable to the application of the amendments made by sec. 2) shall not expire prior to 1 year after the date of such election; and the period within which a claim for credit or refund of an overpayment of tax for such taxable year may be filed (to the extent such overpayment is attributable to such amendments) shall not expire prior to 1 year after the date of such election. No interest shall be payable with respect to any deficiency attributable to the application of the amendments made by section 2, and no interest shall be allowed with respect to any overpayment attributable to the application of such amendments, for any period prior to the date of the enactment of this bill. An election by a taxpayer to have such amendments apply to years beginning after 1957 shall be deemed a consent to the application of subsection (c)(3).

V. CHANGES IN EXISTING LAW

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

INTERNAL REVENUE CODE OF 1954

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SEC. 691. RECIPIENTS OF INCOME IN RESPECT OF DECEDENTS

(a) INCLUSION IN GROSS INCOME.—

(1) GENERAL RULE.—The amount of all items of gross income in respect of a decedent which are not properly includible in respect of the taxable period in which falls the date of his death or a prior period (including the amount of all items of gross income in respect of a prior decedent, if the right to receive such amount was acquired by reason of the death of the prior decedent or by bequest, devise, or inheritance from the prior decedent) shall be included in the gross income, for the taxable year when received, of:

(A) the estate of the decedent, if the right to receive the amount is acquired by the decedent's estate from the decedent;

(B) the person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right to receive the amount is not acquired by the decedent's estate from the decedent; or

(C) the person who acquires from the decedent the right to receive the amount by bequest, devise, or inheritance, if the amount is received after a distribution by the decedent's estate of such right.

(2) INCOME IN CASE OF SALE, ETC.—If a right, described in paragraph (1), to receive an amount is transferred by the estate of the decedent or a person who received such right by reason of the death of the decedent or by bequest, devise, or inheritance from the decedent, there shall be included in the gross income of the estate or such person, as the case may be, for the taxable period in which the transfer occurs, the fair market value of such right at the time of such transfer plus the amount by which any consideration for the transfer exceeds such fair market value. For purposes of this paragraph, the term "transfer" includes sale, exchange, or other disposition, or the satisfaction of an installment obligation at other than face value, but does not include transmission at death to the estate of the decedent or a transfer to a person pursuant to the right of such person to receive such amount by reason of the death of the decedent or by bequest, devise, or inheritance from the decedent.

(3) CHARACTER OF INCOME DETERMINED BY REFERENCE TO DECEDENT.—The right, described in paragraph (1), to receive an amount shall be treated, in the hands of the estate of the decedent or any person who acquired such right by reason of the death of the decedent, or by bequest, devise, or inheritance from the decedent, as if it had been acquired by the estate or such person in the transaction in which the right to receive the income was originally derived and the amount includible in gross income under paragraph (1) or (2) shall be considered in the hands of the estate or such person to have the character which it would have had in the hands of the decedent if the decedent had lived and received such amount.

(4) INSTALLMENT OBLIGATIONS ACQUIRED FROM DECEDENT.—In the case of an installment obligation received by a decedent on the sale or other disposition of property, the income from which was properly reportable by the decedent on the installment basis under section 453, if such obligation is acquired by the decedent's estate from the decedent or by any person by reason of the death of the decedent or by bequest, devise, or inheritance from the decedent—

(A) an amount equal to the excess of the face amount of such obligation over the basis of the obligation in the hands of the decedent (determined under section 453(d))shall, for the purpose of paragraph (1), be considered as an item of gross income in respect of the decedent; and

(B) such obligation shall, for purposes of paragraphs (2) and (3), be considered a right to receive an item of gross income in respect of the decedent, but the amount includible in gross income under paragraph (2) shall be reduced by an amount equal to the basis of the obligation in the hands of the decedent (determined under section 453(d)).

(b) ALLOWANCE OF DEDUCTIONS AND CREDIT.—The amount of any deduction specified in section 162, 163, 164, 212, or 611 (relating to deductions for expenses, interest, taxes, and depletion) or credit specified in section 33 (relating to foreign tax credit), in respect of a decedent which is not properly allowable to the decedent in respect

of the taxable period in which falls the date of his death, or a prior period, shall be allowed:

(1) EXPENSES, INTEREST, AND TAXES.—In the case of a deduction specified in section 162, 163, 164, or 212 and a credit specified in section 33, in the taxable year when paid—

(A) to the estate of the decedent; except that

(B) if the estate of the decedent is not liable to discharge the obligation to which the deduction or credit relates, to the person who, by reason of the death of the decedent or by bequest, devise, or inheritance acquires, subject to such obligation, from the decedent an interest in property of the decedent.

(2) DEPLETION.—In the case of the deduction specified in section 611, to the person described in subsection (a)(1) (A), (B), or (C) who, in the manner described therein, receives the income to which the deduction relates, in the taxable year when such income is received.

(c) DEDUCTION FOR ESTATE TAX.—

(1) ALLOWANCE OF DEDUCTION.—

(A) GENERAL RULE.—A person who includes an amount in gross income under subsection (a) shall be allowed, for the same taxable year, as a deduction an amount which bears the same ratio to the estate tax attributable to the net value for estate tax purposes of all the items described in subsection (a)(1) as the value for estate tax purposes of the items of gross income or portions thereof in respect of which such person included the amount in gross income (or the amount included in gross income, whichever is lower) bears to the value for estate tax purposes of all the items described in subsection (a)(1).

(B) ESTATES AND TRUSTS.—In the case of an estate or trust, the amount allowed as a deduction under subparagraph (A) shall be computed by excluding from the gross income of the estate or trust the portion (if any) of the items described in subsection (a)(1) which is properly paid, credited, or to be distributed to the beneficiaries during the taxable year. This subparagraph shall apply to the same taxable years, and the same extent, as is provided in section 683.

(2) METHOD OF COMPUTING DEDUCTION.—For purposes of paragraph (1)—

(A) The term "estate tax" means the tax imposed on the estate of the decedent or any prior decedent under section 2001 or 2101, reduced by the credits against such tax.

(B) The net value for estate tax purposes of all the items described in subsection (a)(1) shall be the excess of the value for estate tax purposes of all the items described in subsection (a)(1) over the deductions from the gross estate in respect of claims which represent the deductions and credit described in subsection (b). Such net value shall be determined with regard to the provisions of section 421(d)(6)(B), relating to the deduction for estate tax with respect to restricted stock options.

(C) The estate tax attributable to such net value shall be an amount equal to the excess of the estate tax over the

estate tax computed without including in the gross estate such net value.

(d) AMOUNTS RECEIVED BY SURVIVING ANNUITANT UNDER JOINT AND SURVIVOR ANNUITY CONTRACT.—

(1) DEDUCTION FOR ESTATE TAX.—For purposes of computing the deduction under subsection (c)(1)(A), amounts received by a surviving annuitant—

(A) as an annuity under a joint and survivor annuity contract where the decedent annuitant died after December 31, 1953, and after the annuity starting date (as defined in section 72(c)(4)), and

(B) during the surviving annuitant's life expectancy period,

shall, to the extent included in gross income under section 72, be considered as amounts included in gross income under subsection (a).

(2) NET VALUE FOR ESTATE TAX PURPOSES.—In determining the net value for estate tax purposes under subsection (c)(2)(B) for purposes of this subsection, the value for estate tax purposes of the items described in paragraph (1) of this subsection shall be computed—

(A) by determining the excess of the value of the annuity at the date of the death of the deceased annuitant over the total amount excludible from the gross income of the surviving annuitant under section 72 during the surviving annuitant's life expectancy period, and

(B) by multiplying the figure so obtained by the ratio which the value of the annuity for estate tax purposes bears to the value of the annuity at the date of the death of the deceased.

(3) DEFINITIONS.—For purposes of this subsection—

(A) The term "life expectancy period" means the period beginning with the first day of the first period for which an amount is received by the surviving annuitant under the contract and ending with the close of the taxable year with or in which falls the termination of the life expectancy of the surviving annuitant. For purposes of this subparagraph, the life expectancy of the surviving annuitant shall be determined, as of the date of the death of the deceased annuitant, with reference to actuarial tables prescribed by the Secretary or his delegate.

(B) The surviving annuitant's expected return under the contract shall be computed, as of the death of the deceased annuitant, with reference to actuarial tables prescribed by the Secretary or his delegate.

(e) *INSTALLMENT OBLIGATIONS TRANSMITTED AT DEATH WHEN PRIOR LAW APPLIED TO TRANSMISSION.*—

(1) IN GENERAL.—Effective with respect to the first taxable eyar to which the election referred to in paragraph (2) applies and to each taxable year thereafter, subsection (a)(4) shall apply in the case of installment obligations in respect to which section 44(d) of the Internal Revenue Code of 1939 (or the corresponding provisions of prior law) did not apply by reason of the filing of the bond referred to in such section or provisions. Subsection (c) of this section shall

not apply in respect of any amount included in gross income by reason of this paragraph.

(2) ELECTION.—Installment obligations referred to in paragraph (1) may, at the election of the taxpayer holding such obligations, be treated as obligations in respect of which subsection (a)(4) applies. An election under this subsection for any taxable year shall be made not later than the time prescribed by law (including extensions thereof) for filing the return for such taxable year. The election shall be made in such manner as the Secretary or his delegate may by regulations prescribe.

(3) RELEASE OF BOND.—The liability under any bond filed under section 44(d) of the Internal Revenue Code of 1939 (or the corresponding provisions of prior law) in respect of which an election under this subsection applies is hereby released with respect to taxable years to which such election applies.

[(e)] *(f)* CROSS REFERENCE.—

For application of this section to income in respect of a deceased partner, see section 753.

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SEC. 1038. CERTAIN REACQUISITIONS OF REAL PROPERTY.

(a) GENERAL RULE.—If—

(1) a sale of real property gives rise to indebtedness to the seller which is secured by the real property sold, and

(2) the seller of such property reacquires such property in partial or full satisfaction of such indebtedness,

then, except as provided in subsections (b) and (d), no gain or loss shall result to the seller from such reacquisition, and no debt shall become worthless or partially worthless as a result of such reacquisition.

(b) AMOUNT OF GAIN RESULTING.—

(1) IN GENERAL.—In the case of a reacquisition of real property to which subsection (a) applies, gain shall result from such reacquisition to the extent that—

(A) the amount of money and the fair market value of other property (other than obligations of the purchaser) received, prior to such reacquisition, with respect to the sale of such property, exceeds

(B) the amount of the gain on the sale of such property returned as income for periods prior to such reacquisition.

(2) LIMITATION.—The amount of gain determined under paragraph (1) resulting from a reacquisition during any taxable year beginning after the date of the enactment of this section shall not exceed the amount by which the price at which the real property was sold exceeded its adjusted basis, reduced by the sum of—

(A) the amount of the gain on the sale of such property returned as income for periods prior to the reacquisition of such property, and

(B) the amount of money and the fair market value of other property (other than obligations of the purchaser received with respect to the sale of such property) paid or transferred by the seller in connection with the reacquisition of such property.

For purposes of this paragraph, the price at which real property is sold is the gross sales price reduced by the selling commissions, legal fees, and other expenses incident to the sale of such property which are properly taken into account in determining gain or loss on such sale.

(3) GAIN RECOGNIZED.—*Except as provided in this section, the gain determined under this subsection resulting from a reacquisition to which subsection (a) applies shall be recognized notwithstanding any other provision of this subtitle.*

(c) BASIS OF REACQUIRED REAL PROPERTY.—*If subsection (a) applies to the reacquisition of any real property, the basis of such property upon such reacquisition shall be the adjusted basis of the indebtedness to the seller secured by such property (determined as of the date of reacquisition), increased by the sum of—*

(1) the amount of the gain determined under subsection (b) resulting from such reacquisition, and

(2) the amount described in subsection (b)(2)(B).

If any indebtedness to the seller secured by such property is not discharged upon the reacquisition of such property, the basis of such indebtedness shall be zero.

(d) INDEBTEDNESS TREATED AS WORTHLESS PRIOR TO REACQUISITION.—*If, prior to a reacquisition of real property to which subsection (a) applies, the seller has treated indebtedness secured by such property as having become worthless or partially worthless—*

(1) such seller shall be considered as receiving, upon the reacquisition of such property, an amount equal to the amount of such indebtedness treated by him as having become worthless, and

(2) the adjusted basis of such indebtedness shall be increased (as of the date of reacquisition) by an amount equal to the amount so considered as received by such seller.

(e) PRINCIPAL RESIDENCES.—*If—*

(1) subsection (a) applies to a reacquisition of real property with respect to the sale of which—

(A) an election under section 121 (relating to gain from sale or exchange of residence of an individual who has attained age 65) is in effect, or

(B) gain was not recognized under section 1034 (relating to sale or exchange of residence; and

(2) within one year after the date of the reacquisition of such property by the seller, such property is resold by him,

then, under regulations prescribed by the Secretary or his delegate, subsections (b), (c), and (d) of this section shall not apply to the reacquisition of such property and, for purposes of applying sections 121 and 1034, the resale of such property shall be treated as a part of the transaction constituting the original sale of such property.

(f) REACQUISITIONS BY DOMESTIC BUILDING AND LOAN ASSOCIATIONS.—*This section shall not apply to a reacquisition of real property by an organization described in section 593(a) (relating to domestic building and loan associations, etc.).*

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