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REPORT
No. 1241

COLLAPSIBLE CORPORATIONS; PERSONAL HOLDING COMPANIES

JULY 27, 1964.—Ordered to be printed

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

REPORT

[To accompany H.R. 7301]

The Committee on Finance, to whom was referred the bill (H.R. 7301) to amend section 341 of the Internal Revenue Code of 1954, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

I. SUMMARY

Your committee has added a provision to the House bill, H.R. 7301, as well as making relatively minor modifications to the House-passed provisions.

H.R. 7301 as passed by the House amends the "collapsible corporation" provisions of the tax laws so that they will not apply to the sale of stock in a corporation which consents to a special tax treatment on any later disposition by it of its assets. Under the bill, the corporation must consent to the recognition of gain on dispositions by the corporation of its assets in the same manner as if these assets had been sold for their fair market values. The gain recognized will be ordinary income, if ordinary income would have been recognized on a sale of the assets by the corporation, and will be capital gain if capital gain would have been recognized on such a sale.

The Treasury Department has indicated that it does not object to the House-passed provision or to the amendments made in it by your committee.

Your committee has added an amendment dealing with the definition of rents in defining personal holding company income. This amendment provides that in certain circumstances, royalties received for the privilege of using a patent, invention, or similar property are to be treated as rent if the patent, etc., also is used by the corporation in the

manufacture of personal property which it leases to customers. The Treasury Department has indicated that it does not object to this amendment.

II. COLLAPSIBLE CORPORATION PROVISIONS

Present law.—A collapsible corporation is, in general, a corporation used to enable the shareholders to realize the gain on property owned by the corporation without the recognition of taxable gain to the corporation. Frequently, the gain which would have been recognized to the corporation would have been ordinary income instead of the capital gain normally recognized to shareholders. To prevent this result, the present statute provides that gain resulting from the sale of stock of a "collapsible corporation" is treated as ordinary income.

Reasons for bill.—The problem with which the first section of this bill deals centers around the sale of stock of a corporation that is rapidly growing and expects to continue in business but which holds constructed or produced properties which are worth substantially more than their cost and upon which there has not been substantial realization of the profits to be derived from the properties. The shareholders, through a sale of stock (whether or not through a "public offering"), would like to capitalize on the future prospects of this growing company. The buyers of the stock clearly intend to have the corporation continue in business. However, on such a stock sale, the corporation might be regarded as fitting precisely into the literal definition of a collapsible corporation (under sec. 341(b)) if the shareholders intended to sell the stock of the corporation prior to the realization by the corporation of a substantial part of the income to be derived from the constructed or produced property. Moreover, the corporation usually cannot qualify under any of the several existing exceptions, principally because it has not had a substantial prior business history and is growing rapidly.

Explanation of bill.—This section meets the problem described above by providing that the collapsible provisions will not apply to the sale of stock in a corporation which consents to a special type of tax treatment described below. The treatment provided has the effect of assuring that ultimately there will be the same tax consequences as if the assets had been sold before the stock.

In general, the sale of the corporation's stock is not to be treated as a collapsible sale, if the corporation consents to the recognition of gain by it on every disposition of assets (other than certain capital assets) owned (or held under option) by the corporation on the date of sale. The assets subject to this special treatment are referred to in the bill as "subsection (f) assets." Thus, for example, notwithstanding the provision in the tax laws relating to the nonrecognition of gain or loss on the distribution of property in partial or complete liquidation (sec. 336) or the provision relating to nonrecognition of gain or loss on sales or exchanges in connection with certain 1-year liquidations (sec. 337), a consenting corporation would be required to recognize gain on the disposition of its subsection (f) assets in either of these cases. This rule providing recognition of gain does not apply if the subsection (f) assets are transferred in one of various tax-free transactions in which the cost or other basis carries over to

the recipient corporation if that corporation consents to the special tax treatment provided in this bill with respect to the assets received.[1] The rule does apply, however (i.e., gain is recognized), if the recipient corporation does not so consent or is a tax-exempt organization.

Your committee has amended the House-passed bill in one particular. This amendment makes it clear that "unrealized receivables or fees" (as defined in subsec. (b)(4) of sec. 341) are included in the class of "subsection (f)" assets. Your committee does not intend that any implication be drawn from this as to the tax status of "unrealized receivables or fees" in any other context.

This provision will not apply to a shareholder who had sold stock of another consenting corporation within the preceding 5 years, and is effective only with respect to transactions after the date of the enactment of this bill.

The relief provided by this provision is based upon the theory that if an individual sells stock in a single corporation and this corporation continues in existence and realizes the gain on the constructed or produced property, there can be no elimination of tax at the corporate level with respect to this property. Thus, under these circumstances, the principal problem at which the collapsible corporation provision is directed would not exist, and your committee agreed with the House that it would be unnecessary to apply the collapsible provisions to the stockholders of such a corporation upon their sale of its stock. If the corporation continues in existence and in the normal course of business realizes the gain inherent in the subsection (f) assets, it will be treated as any other corporation where the stock had not been sold. On the other hand, if the consenting corporation is liquidated, the special tax treatment associated with the consent provided by this provision would require it to pay a tax on the unrealized appreciation of its subsection (f) assets when they are distributed. Thus the unrealized appreciation in the subsection (f) assets does not escape tax in any case.

It should be noted that if the purchaser is not interested in the corporation as a going concern but intends to liquidate it to secure the assets, then the selling shareholder will be in no better position than he would be under existing law if the corporation sold the properties and then were liquidated. This is true because such a purchaser in his offering price would take into account the potential Federal tax liability on the unrealized appreciation in the assets.

On the other hand, this provision will benefit one who sells to a purchaser who intends to continue the corporate business. Such a purchaser would, of course, also allow for the built-in future tax liabilities arising from the consent but these liabilities would be no different from those arising where a going business was purchased where the collapsible provisions are not applicable. Of course, the purchase price in such a case would include an amount for the "going concern" value of the business.

Effective date.—The new rule provided by the first section of this bill is to apply with respect to transactions after the date of enactment of the bill.

Revenue effect.—It is believed that the first section of this bill will have a negligible effect on revenues.

[1] The tax-free transactions referred to are those provided for by secs. 332, 351, 361, 371(a), and 374(a).

III. CERTAIN PERSONAL HOLDING COMPANY INCOME DERIVED FROM THE USE OF PATENTS, ETC.

The Revenue Act of 1964 made substantial changes in the personal holding company provisions of prior law. One of these changes relates to the definition of "personal holding company income" in cases where the corporation involved receives a substantial part of its gross income from the rental of real or personal property.

Under the law prior to the enactment of the Revenue Act of 1964 personal holding company income did not include rents from real or personal property where these represented 50 percent or more of the corporation's income. Where less than this percentage of the corporation's gross income was rental income, the rent was treated as personal holding company income along with other investment-type income of the corporation. In general, it was thought that where rental income represented the major activity, the activity involved was more likely to be of an active rather than a passive character.

Under the law as amended by the Revenue Act of 1964, certain modifications were made in this 50 percent test: Under the new provision adjusted income from rents must be 50 percent or more of adjusted ordinary gross income.[2] In addition, however, Congress in the Revenue Act of 1964 added a second test providing that rental income is to be characterized as passive (or personal holding company income) even where it meets the 50-percent test if, apart from the rental income, more than 10 percent of the undistributed ordinary gross income of the company is personal holding company income. The intent of this second test was to give assurance that the rental income cannot be used to shelter any appreciable amount of other passive income.

It has come to the attention of your committee that the effect of this 10-percent test in its present form is to characterize some closely held corporations, which are primarily manufacturing enterprises, as personal holding companies. For example, where a closely held corporation derives most of its income from the leasing of tangible personal property which it manufactured by using certain patent, secret processes, or other similar property rights which it held, but also receives royalties from the use of these patents, etc., if these royalties exceed 10 percent of the corporation's ordinary gross income (unless this income is distributed) this will result in the failure of the company to meet the 10-percent test added by the Revenue Act of 1964. As a result, both the royalties and the rent from leasing the personal property are treated in such a case as personal holding company income.

Your committee does not believe that Congress intended to treat corporations as personal holding companies if they are engaged in the normal operation of a manufacturing enterprise, utilizing patents and know-how to manufacture products for lease merely because they also obtain royalty income from this patent, etc.

The amendment added by your committee modifies the 10-percent test (sec. 543(a)(2)) to provide that royalties received from patents, inventions, models, designs, secret formulas or processes, or other

[2] Adjusted rental income in this case is gross rents less interest, taxes, depreciation on rental property, and rents paid. The same deductions are also made in arriving at adjusted ordinary gross income, as well as certain other deductions not of concern here.

similar property rights are to be treated as "rent" in applying the 10-percent test where these patents, etc., are also used by the corporation in the manufacture of tangible personal property held by it for lease to customers. However, royalty income in such a case is to be treated as rental income only in those cases where the rental income from leases under such patents, etc. (without treating the royalties as rental income), represents 50 percent or more of the adjusted gross ordinary income of the corporation. Thus, in those cases where this rental income already meets the 50-percent test, royalty income to the extent derived from patents used in the manufacture of property for rent is not to result in the failure of the company to meet the 10-percent test, and, therefore, will not result in such a case in the rental income being characterized as personal holding company income merely because of the presence of the royalty income.

The new provision applies to taxable years beginning after December 31, 1963, the years affected by the amendments made by the Revenue Act of 1964 to the personal holding company provisions.

This provision is expected to result in a negligible loss of revenue.

IV. TECHNICAL EXPLANATION OF COLLAPSIBLE CORPORATION PROVISIONS

Subsection (a) of the first section of the bill amends section 341 of the Internal Revenue Code of 1954 (relating to collapsible corporations) by adding at the end thereof a new subsection (f). The new subsection contains an exception to the general rule of section 341(a)(1) which characterizes gain from the sale or exchange of stock in a collapsible corporation which is held for more than 6 months as gain from the sale or exchange of property which is not a capital asset. The new subsection provides, in general, that section 341(a)(1) shall not apply to a sale of stock of a corporation if such corporation consents to recognize gain on any future disposition by it of its "subsection (f) assets" (defined, generally, as assets of the corporation other than certain capital assets, owned or held under option on the date the stock of the corporation is sold) and if the sale of the stock is made within the 6-month period after the consent is filed. A corporation which consents to the special tax treatment provided in the new subsection does not thereby become noncollapsible; the relief provided by the subsection extends only to those shareholders of the consenting corporation who meet the particular requirements contained therein. The fact that a corporation consents to the provisions of subsection (f) is not to affect the determination as to whether it is a collapsible corporation.

In general

Paragraph (1) of the new subsection provides that section 341(a)(1) shall not apply to a sale of stock of a corporation (other than a sale to the issuing corporation) if such corporation consents to have the provisions of paragraph (2) of the new subsection apply. Thus, the benefits of the new subsection are not available in respect of gain derived by shareholders from transactions described in section 341(a)(2), relating to distributions in partial or complete liquidation of a corporation which are treated as in part or full payment in exchange for stock, or from transactions described in section 341(a)(3), relating to certain distributions by a corporation which are treated

under section 301(c)(3)(A) in the same manner as gain from the sale or exchange of property.

The consent which is required of a corporation under paragraph (1) of the new subsection (f) is to be made at such time and in such manner as the Secretary of the Treasury or his delegate may by regulations prescribe. Such consent shall apply with respect to each sale of stock by shareholders of the consenting corporation made within the 6-month period beginning with the date on which the consent is filed. A corporation may file as many consents as it wishes. If a consent is filed by a corporation pursuant to the provisions of paragraph (1) and a shareholder sells his stock in such corporation at any time during the applicable 6-month period, then the consent cannot thereafter be revoked by the corporation, and any subsequent determination to the effect that the corporation was not a collapsible corporation within the meaning of section 341 (b) on the date of such sale does not vitiate the consent; that is, the corporation remains subject to the special tax treatment provided in subsection (f)(2) on any subsequent disposition of subsection (f) assets.

Recognition of gain

Paragraph (2) of the new subsection provides the special tax treatment applicable to corporations which consent to such treatment under subsection (f)(1). Paragraph (2) provides that if a "subsection (f) asset" (as defined in sec. 341(f)(4)) is disposed of at any time by a consenting corporation (or, if sec. 341(f)(3) applies, by a transferee corporation), then the amount by which the amount realized (in the case of a disposition which is a sale, exchange, or involuntary conversion), or by which the fair market value of such asset (in the case of any other disposition), exceeds the adjusted basis of such asset is to be treated as gain to the consenting corporation (or to the transferee corporation) from the sale or exchange of such asset. Such gain shall be recognized notwithstanding any other provision of subtitle A of the code but only to the extent such gain is not recognized under any other provision of subtitle A of the code. The amount of gain is determined separately for each subsection (f) assets disposed of by the corporation.

The provisions of paragraph (2) of the new subsection (f) may be illustrated by the following examples:

Example (1).—Corporation X, a consenting corporation, distributes a subsection (f) asset to its shareholders in complete or partial liquidation of the corporation. The asset, at the time of the distribution, is held by the corporation primarily for sale to customers in the ordinary course of business and has an adjusted basis of $1,000 and a fair market value of $2,000. Under section 341(f)(2), the excess of the fair market value of the asset over its adjusted basis is treated as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231. Corporation X recognizes the $1,000 gain as ordinary income even though, in the absence of section 341(f)(2), section 336 would preclude the recognition of such gain.

Example (2).—Corporation Y, a consenting corporation, distributes a subsection (f) asset to its shareholders as a dividend. The asset, at the time of the distribution, is property described in section 1231 and has an adjusted basis of $6,000 and a fair market value of $8,000. Under section 341(f)(2), the excess of the fair market value of the asset over its adjusted basis, or $2,000, is treated by corporation Y as gain from the sale or exchange of property which is described in section

1231. Corporation Y recognizes the $2,000 gain even though, in the absence of section 341(f)(2), section 311(a) would preclude the recognition of such gain.

Example (3).—Assume the same facts as in example (2) except that the subsection (f) asset is section 1245 property having a "recomputed basis" (as defined in sec. 1245(a)(2)) of $7,200. Since the recomputed basis of the asset is lower than its fair market value, the excess of recomputed basis over adjusted basis, or $1,200, is treated as ordinary income under section 1245 (a)(1). The remaining amount, which is treated as gain under section 341(f)(2), or $800, is recognized under such section as gain from the sale or exchange of property described in section 1231.

Exception for certain tax-free transactions

Paragraph (3) of the new subsection provides an exception to the recognition provisions of paragraph (2). Under paragraph (3) if the basis of a subsection (f) asset in the hands of a transferee corporation is determined by reference to its basis in the hands of the transferor corporation by reason of the application of certain sections of the code providing for nonrecognition treatment, and if the transferee agrees (at such time, and in such manner as the Secretary of the Treasury or his delegate may by regulations prescribe) to have the provisions of subsection (f)(2) apply to any disposition by it of such subsection (f) asset, then the amount of gain is limited to the gain recognized by the transferor under such nonrecognition sections. The nonrecognition sections referred to are the following: Section 332 (relating to distributions in liquidation of an 80 percent or more controlled subsidiary corporation); section 351 (relating to transfers to a corporation controlled by the transferor); section 361 (relating to exchanges pursuant to certain corporate reorganizations); section 371(a) (relating to exchanges pursuant to certain receivership and bankruptcy proceedings); and section 374(a) (relating to exchanges pursuant to certain railroad reorganizations). The agreement made by the transferee corporation does not convert it into a consenting corporation, thereby permitting its shareholders to gain the benefit of the relief provided by the new subsection (f). Such relief would be available to the shareholders of the transferee corporation only if the transferee files a consent as provided in subsection (f)(1). Subsection (f)(3) does not apply to a disposition of property to an organization which is exempt from tax imposed by chapter 1 of the code, but no implication is intended as to whether a transfer to such an exempt organization could or could not qualify for nonrecognition under the sections of the code referred to in subsection (f)(3).

The provisions of paragraph (3) of the new subsection (f) may be illustrated by the following example:

Example.—Corporation X, in exchange for its voting stock worth $20,000 and $1,000 cash, acquires the entire property of corporation Y (an unencumbered apartment building) in a transaction which is described in section 368(a)(2)(B) and which, therefore, qualifies as a reorganization under section 368(a)(1)(C). The apartment building, which in the hands of corporation Y, a consenting corporation, is a subsection (f) asset, has an adjusted basis of $15,000, and, a fair market value of $21,000. The basis of the apartment house in the hands of corporation X is determined by reference to its basis in the hands of corporation Y by reason of the application of section 361.

Thus, under section 341(f)(3), if corporation X agrees to have the provisions of section 341(f)(2) apply to any disposition by it of the apartment house, the gain recognized to corporation Y under section 341(f)(2) is limited to $1,000, since such amount was not distributed and therefore would be recognized by corporation Y under section 361(b). However, if corporation X does not so agree, the gain recognized by corporation Y will be $6,000, that is, the gain of $1,000 recognized under section 361(b), plus $5,000 gain recognized under section 341(f)(2). In either case, if section 1245 or 1250 applies, some, or all, of the gain may be recognized under such sections in lieu of section 341(f)(2).

Subsection (f) asset defined

Paragraph (4) of the new subsection contains the definition of the term "subsection (f) asset." Subsection (f) assets are the assets of the corporation with respect to which the special tax consequences described in paragraph (2) apply. A subsection (f) asset is defined as any property which, as of the date of any sale of stock made during the applicable 6-month period of a consenting corporation, is not a capital asset and is property owned by, or subject to an option to acquire held by, the consenting corporation. For purposes of this definition, land or any interest in real property, such as a leasehold interest will, in no event, be treated as a capital asset. An interest in real property does not include a mere security interest, such as a mortgage. Also, for purposes of this definition "unrealized receivables" or fees" (as defined in subsec. (b)(4) of sec. 341) will, in no event, be treated as capital assets.

If, with respect to any property described in subsection (f)(3)(A), manufacturing, construction, or production has commenced by either the consenting corporation or another person before any date of sale described in such subsection, a consenting corporation's subsection (f) assets will include any property resulting from such manufacture, construction, or production. Thus, for example, if, on the date of any sale of stock within the 6-month period, construction or production has commenced on a tract of land to be used for residential housing or on a television series, the term "subsection (f) asset" includes the residential homes or the television tapes resulting from the future construction, etc., by the consenting corporation (or a transferee corporation which has agreed to the application of subsec. (f)(2)). If land or any interest in real property (other than a security interest) is owned or held under an option on the date of any sale during the 6-month period, this same rule applies if construction commences within 2 years after the date of any such sale. For purposes of paragraph (4), the term "commenced" means any activity which constitutes the commencement of manufacture, etc., within the meaning of section 341.

The provisions of paragraph (4) of new subsection (f) may be illustrated by the following examples:

Example (1).—Corporation X files a consent to the application of subsection (f)(2) on January 1, 1965. Shareholder A owns 100 percent of the outstanding stock of the consenting corporation on January 1, 1965, and he sells 5 percent of the stock on January 2, 1965; 10 percent on February 10, 1965; and 1 percent on May 1, 1965.

No other sales of X stock were made during the 6-month period beginning January 1, 1965. On January 1, X owns an apartment building and on March 1 X busy an office building. X's subsection (f) assets include the apartment building owned on January 1 and the office building purchased on March 1.

Example (2).—Assume the same facts as in example (1) except that on January 1, 1965, X also owns a tract of raw land. On April 1, 1965, construction of a residential housing project is commenced on the tract of land. Corporation X's subsection (f) assets will include the tract of land plus the resulting improvements to the land. This result would not be changed if construction of the residential housing project was not commenced until July 1, 1966, since the construction was commenced within 2 years after May 1, 1965.

Five-year limitation as to shareholder

Paragraph (5) of the new subsection provides that the provisions of paragraph (1) of such subsection shall not apply to the sale of stock by a shareholder of a consenting corporation if, during the 5-year period ending on the date of such sale, such shareholder (or any person related to such shareholder within the meaning of section 341(e)(8)(A)) sold any stock of another consenting corporation within any 6-month period beginning on a date on which a consent was filed under subsection (f)(1) by such other corporation. This paragraph does not prevent a shareholder of a consenting corporation from selling additional shares of the stock of such same consenting corporation.

Special rule for stockownership in other corporations

Paragraph (6) of the new subsection provides a special rule applicable to a corporation (hereinafter referred to as "owning corporation") which owns 5 percent or more in value of the outstanding stock of another corporation. In such a case, in addition to the consent which is required under subsection (f)(1) by the owning corporation, each of the other corporations in which the owning corporation has such an interest must also file a consent. Paragraph (6) provides that a consent filed by an owning corporations shall not be valid with respect to a sale of its stock during the applicable 6-month period unless each corporation, 5 percent or more in value of the outstanding stock of which is owned by the owning corporation on the date of such sale, files (within a 6-month period ending on the date of such sale) a valid consent under subsection (f)(1) with respect to sales of its own stock. Thus, for example, assume corporation X owns 80 percent of the only class of stock of corporation Y on January 1, 1966, the date on which a shareholder of corporation X sells X's stock. Assume further that corporation X filed a consent on November 1, 1965. In order for the consent filed by corporation X to be valid with respect to the sale of its stock on January 1, 1966, corporation Y must have filed during the 6-month period ending on January 1, 1966, a valid consent under subsection (f)(1) with respect to sales of its stock.

Paragraph (6) of the new subsection further provides that for purposes of applying paragraph (4) of the new subsection to a corporation, 5 percent or more in value of the outstanding stock of which is owned by the owning corporation, a sale of stock of the owning corporation to which subsection (f)(1) applies shall be treated as a sale of stock in such other corporation. Thus, in the example in the preceding para-

graph, the subsection (f) assets of corporation Y would include property described in subsection (f)(4) owned by, or subject to an option to acquire held by, corporation Y on January 1, 1966. If in the above example corporation Y had filed its consent on December 1, 1965, and a stockholder of Y had sold his stock in Y on February 1, 1966, Y's subsection (f) assets would include not only property owned by, or subject to an option to acquire held by, Y, on January 1, 1966, but also any such property acquired after January 1, 1966, and not disposed of before February 2, 1966.

Paragraph (6) of the new subsection further provides that in the case of a chain of corporations connected by the 5-percent ownership requirements of such paragraph, rules similar to the rules described in the two preceding paragraphs shall apply. Thus, if in the example in the preceding paragraphs Y corporation owned more than 5 percent of the stock of Z corporation of January 1, 1966, Z corporation must have filed a valid consent during the 6-month period ending on January 1, 1966, and any sale of stock of either X or Y corporation shall be treated as a sale of stock of Z corporation for purposes of applying subsection (f)(4).

Adjustments to basis

Paragraph (7) of the new subsection provides that the Secretary of the Treasury or his delegate shall perscribe such regulations as he may deem necessary to provide for adjustments to the basis of property to reflect gain recognized under subsection (f)(2).

(*b*) *Technical amendments.*—Paragraph (1) of subsection (b) of the bill amends subsections (b) and (d) of section 301 (relating to amount distributed), and paragraph (3) of section 312(c) (relating to adjustments of earnings and profits), of the code by striking out "section 311" and inserting in lieu thereof "section 311, under section 341(f),".

Paragraph (2) of subsection (b) of the bill amends subparagraphs (A) and (B) of section 453(d)(4) of the code (relating to distribution of installment obligations in certain corporate liquidations) by inserting "section 341(f) or" before "section 1245(a)".

Effective date

Section 2 of the bill provides that the amendments made by the first section of the bill shall apply with respect to transactions after the date of the enactment of the bill in taxable years ending after such date.

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

SEC. 301. DISTRIBUTION OF PROPERTY.

* * * * * * *

(b) AMOUNT DISTRIBUTED.—

(1) GENERAL RULE.—For purposes of this section, the amount of any distribution shall be—

(A) NONCORPORATE DISTRIBUTEES.—If the shareholder is not a corporation, the amount of money received, plus the fair market value of the other property received.

(B) CORPORATE DISTRIBUTEES.—If the shareholder is a corporation, the amount of money received, plus whichever of the following is the lesser:

(i) the fair market value of the other property received; or

(ii) the adjusted basis (in the hands of the distributing corporation immediately before the distribution) of the other property received, increased in the amount of gain to the distributing corporation which is recognized under subsection (b) or (c) of section 311, *under section 341(f)*, or under section 1245(a).

(C) CERTAIN CORPORATE DISTRIBUTEES OF FOREIGN CORPORATION.—Notwithstanding subparagraph (B), if the shareholder is a corporation and the distributing corporation is a foreign corporation, the amount taken into account with respect to property (other than money) shall be the fair market value of such property; except that if any deduction is allowable under section 245 with respect to such distribution, then the amount taken into account shall be the sum (determined under regulations prescribed by the Secretary or his delegate) of—

(i) the proportion of the adjusted basis of such property (or, if lower, its fair market value) properly attributable to gross income from sources within the United States, and

(ii) the proportion of the fair market value of such property properly attributable to gross income from sources without the United States.

(2) REDUCTION FOR LIABILITIES.—The amount of any distribution determined under paragraph (1) shall be reduced (but not below zero) by—

(A) the amount of any liability of the corporation assumed by the shareholder in connection with the distribution, and

(B) the amount of any liability to which the property received by the shareholder is subject immediately before, and immediately after, the distribution.

(3) DETERMINATION OF FAIR MARKET VALUE.—For purposes of this section, fair market value shall be determined as of the date of the distribution.

* * * * * * *

(d) BASIS.—The basis of property received in a distribution to which subsection (a) applies shall be—

(1) NONCORPORATE DISTRIBUTEES.—If the shareholder is not a corporation, the fair market value of such property.

(2) CORPORATE DISTRIBUTEES.—If the shareholder is a corporation, whichever of the following is the lesser:

(A) the fair market value of such property; or

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

corporation which is recognized under subsection (b) or (c) of section 311, *under section 341(f)*, or under section 1245(a).

(3) CERTAIN CORPORATE DISTRIBUTEES OF FOREIGN CORPORATION.—In the case of property described in subparagraph (C) of subsection (b)(1), the basis shall be determined by substituting the amount determined under such subparagraph (C) for the amount described in paragraph (2) of this subsection.

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SEC. 312. EFFECT ON EARNINGS AND PROFITS.

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(c) ADJUSTMENTS FOR LIABILITIES, ETC.—In making the adjustments to the earnings and profits of a corporation under subsection (a) or (b), proper adjustment shall be made for—

(1) the amount of any liability to which the property distributed is subject,

(2) the amount of any liability of the corporation assumed by a shareholder in connection with the distribution, and

(3) any gain to the corporation recognized under subsection (b) or (c) of section 311, *under section 341(f)*, or under section 1245(a).

* * * * * * *

SEC. 341. COLLAPSIBLE CORPORATIONS.

(a) TREATMENT OF GAIN TO SHAREHOLDERS.—Gain from—

(1) the sale or exchange of stock of a collapsible corporation,

(2) a distribution in partial or complete liquidation of a collapsible corporation, which distribution is treated under this part as in part or full payment in exchange for stock, and

(3) a distribution made by a collapsible corporation which, under section 301(c)(3)(A), is treated, to the extent it exceeds the basis of the stock, in the same manner as a gain from the sale or exchange of property,

to the extent that it would be considered (but for the provisions of this section) as gain from the sale or exchange of a capital asset held for more than 6 months shall, except [as provided in subsection (d)] *as otherwise provided in this section*, be considered as gain from the sale or exchange of property which is not a capital asset.

(b) DEFINITIONS.—

(1) COLLAPSIBLE CORPORATION.—For purposes of this section, the term "collapsible corporation" means a corporation formed or availed of principally for the manufacture, construction, or production of property, for the purchase of property which (in the hands of the corporation) is property described in paragraph (3), or for the holding of stock in a corporation so formed or availed of, with a view to—

(A) the sale or exchange of stock by its shareholders (whether in liquidation or otherwise), or a distribution to its shareholders, before the realization by the corporation manufacturing, constructing, producing, or purchasing the property of a substantial part of the taxable income to be derived from such property, and

(B) the realization by such shareholders of gain attributable to such property.

(2) PRODUCTION OR PURCHASE OF PROPERTY.—For purposes of paragraph (1), a corporation shall be deemed to have manufactured, constructed, produced, or purchased property, if—

(A) it engaged in the manufacture, construction, or production of such property to any extent,

(B) it holds property having a basis determined, in whole or in part, by reference to the cost of such property in the hands of a person who manufactured, constructed, produced, or purchased the property, or

(C) it holds property having a basis determined, in whole or in part, by reference to the cost of property manufactured, constructed, produced, or puchased by the corporation.

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(f) CERTAIN SALES OF STOCK OF CONSENTING CORPORATIONS.—

(1) IN GENERAL.—Subsection (a)(1) shall not apply to a sale of

(2) RECOGNITION OF GAIN.—Except as provided in paragraph stock of a corporation (other than a sale to the issuing corporation) if such corporation (hereinafter in this subsection referred to as "consenting corporation") consents (at such time and in such manner as the Secretary or his delegate may by regulations prescribe) to have the provisions of paragraph (2) apply. Such consent shall apply with respect to each sale of stock of such corporation made within the 6-month period beginning with the date on which such consent is filed.

(2) RECOGNITION OF GAIN.—Except as provided in paragraph (3), if a subsection (f) asset (as defined in paragraph (4)) is disposed of at any time by a consenting corporation (or, if paragraph (3) applies, by a transferee corporation), then the amount by which—

(A) in the case of a sale, exchange, or involuntary conversion, the amount realized, or

(B) in the case of any other disposition, the fair market value of such asset,

exceeds the adjusted basis of such asset shall be treated as gain from the sale or exchange of such asset. Such gain shall be recognized notwithstanding any other provision of this subtitle, but only to the extent such gain is not recognized under any other provision of this subtitle.

(3) EXCEPTION FOR CERTAIN TAX-FREE TRANSACTIONS.—If the basis of a subsection (f) asset in the hands of a transferee is determined by reference to its basis in the hands of the transferor by reason of the application of section 332, 351, 361, 371(a), or 374(a), then the amount of gain taken into account by the transferor under paragraph (2) shall not exceed the amount of gain recognized to the transferor on the transfer of such asset (determined without regard to this subsection). This paragraph shall apply only if the transferee—

(A) is not an organization which is exempt from tax imposed by this chapter, and

(B) agrees (at such time and in such manner as the Secretary or his delegate may by regulations prescribe) to have the provisions of paragraph (2) apply to any disposition by it of such subsection (f) asset.

(4) SUBSECTION (f) ASSET DEFINED.—For purposes of this subsection—

(A) IN GENERAL.—The term "subsection (f) asset" means any property which, as of the date of any sale of stock referred to in paragraph (1), is not a capital asset and is property owned by, or subject to an option to acquire held by, the consenting corporation. For purposes of this subparagraph, land or any interest in real property (other than a security interest), and unrealized receivables or fees (as defined in subsection (b)(4)), shall be treated as property which is not a capital asset.

(B) PROPERTY UNDER CONSTRUCTION.—If manufacture, construction, or production with respect to any property described in subparagraph (A) has commenced before any date of sale described therein, the term "subsection (f) asset" includes the property resulting from such manufacture, construction, or production.

(C) SPECIAL RULE FOR LAND.—In the case of land or any interest in real property (other than a security interest) described in subparagraph (A), the term "subsection (f) asset" includes any improvements resulting from construction with respect to such property if such construction is commenced (by the consenting corporation or by a transferee corporation which has agreed to the application of paragraph (2)) within 2 years after the date of any sale described in subparagraph (A).

(5) FIVE-YEAR LIMITATION AS TO SHAREHOLDER.—Paragraph (1) shall not apply to the sale of stock of a corporation by a shareholder if, during the 5-year period ending on the date of such sale, such shareholder (or any related person within the meaning of subsection (e)(8)(A)) sold any stock of another consenting corporation within any 6-month period beginning on a date on which a consent was filed under paragraph (1) by such other corporation.

(6) SPECIAL RULE FOR STOCK OWNERSHIP IN OTHER CORPORATIONS.—If a corporation (hereinafter in this paragraph referred to as "owning corporation") owns 5 percent or more in value of the outstanding stock of another corporation on the date of any sale of stock of the owning corporation during a 6-month period with respect to which a consent under paragraph (1) was filed by the owning corporation, such consent shall not be valid with respect to such sale unless such other corporation has (within the 6-month period ending on the date of such sale) filed a valid consent under paragraph (1) with respect to sales of its stock. For purposes of applying paragraph (4) to such other corporation, a sale of stock of the owning corporation to which paragraph (1) applies shall be treated as a sale of stock of such other corporation. In the case of a chain of corporations connected by the 5-percent ownership requirements of this paragraph, rules similar to the rules of the 2 preceding sentences shall be applied.

(7) ADJUSTMENTS TO BASIS.—The Secretary or his delegate shall prescribe such regulations as he may deem necessary to provide for adjustments to the basis of property to reflect gain recognized under paragraph (2).

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SEC. 453. INSTALLMENT METHOD.

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(d) GAIN OR LOSS ON DISPOSITION OF INSTALLMENT OBLIGATIONS.—

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(4) EFFECT OF DISTRIBUTION IN CERTAIN LIQUIDATIONS.—

(A) LIQUIDATIONS TO WHICH SECTION 332 APPLIES.—If—

(i) an installment obligation is distributed by one corporation to another corporation in the course of a liquidation, and

(ii) under section 332 (relating to complete liquidations of subsidiaries) no gain or loss with respect to the receipt of such obligation is recognized in the case of the recipient corporation,

then no gain or loss with respect to the distribution of such obligation shall be recognized in the case of the distributing corporation. If the basis of the property of the liquidating corporation in the hands of the distributee is determined under section 334(b)(2) then the preceding sentence shall not apply to the extent that under paragraph (1) gain to the distributing corporation would be considered as gain to which *section 341(f) or* section 1245(a) applies.

(B) LIQUIDATIONS TO WHICH SECTION 337 APPLIES.—If—

(i) an installment obligation is distributed by a corporation in the course of a liquidation, and

(ii) under section 337 (relating to gain or loss on sales or exchanges in connection with certain liquidations) no gain or loss would have been recognized to the corporation if the corporation had sold or exchanged such installment obligation on the day of such distribution,

then no gain or loss shall be recognized to such corporation by reason of such distribution. The preceding sentence shall not apply to the extent that under paragraph (1) gain to the distributing corporation would be considered as gain to which *section 341(f) or* section 1245(a) applies.

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SEC. 543. PERSONAL HOLDING COMPANY INCOME.

(a) GENERAL RULE.—For purposes of this subtitle, the term "personal holding company income" means the portion of the adjusted ordinary gross income which consists of:

(1) DIVIDENDS, ETC.—Dividends, interest, royalties (other than mineral, oil, or gas royalties or copyright royalties), and annuities. This paragraph shall not apply to—

(A) interest constituting rent (as defined in subsection (b)(3)),

(B) interest on amounts set aside in a reserve fund under section 511 or 607 of the Merchant Marine Act, 1936, and

(C) a dividend distribution of divested stock (as defined in subsection (e) of section 1111), but only if the stock with respect to which the distribution is made was owned by the distributee on September 6, 1961, or was owned by the distributee for at least 2 years before the date on which the antitrust order (as defined in subsection (d) of section 1111) was entered.

(2) RENTS.—The adjusted income from rents; except that such adjusted income shall not be included if—

(A) such adjusted income constitutes 50 percent or more of the adjusted ordinary gross income, and

(B) the sum of—

(i) the dividends paid during the taxable year (determined under section 562).

(ii) the dividends considered as paid on the last day of the taxable year under section 563(c) (as limited by the second sentence of section 563(b)), and

(iii) the consent dividends for the taxable year (determined under section 565),

equals or exceeds the amount, if any, by which the personal holding company income for the taxable year (computed without regard to this paragraph and paragraph (6), and computed by including as personal holding company income copyright royalties and the adjusted income from mineral, oil, and gas royalties) exceeds 10 percent of the ordinary gross income. *For purposes of applying this paragraph, royalties received for the use of, or for the privilege of using, a patent, invention, model, or design (whether or not patented), secret formula or process, or any other similar property right shall be treated as rent, if such property right is also used by the corporation receiving such royalties in the manufacture or production of tangible personal property held for lease to customers, and if the amount (computed without regard to this sentence) constituting rent from such leases to customers meets the requirements of subparagraph (A).*

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