Calendar No. 2237

87TH CONGRESS 2d Session | SENATE | REPORT No. 2273

INCOME TAX TREATMENT OF TERMINAL RAILROADS

OCTOBER 3, 1962.—Ordered to be printed

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

REPORT

[To accompany H.R. 12599]

The Committee on Finance, to whom was referred the bill (H.R. 12599) relating to the income tax treatment of terminal railroad corporations and their shareholders, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

I. SUMMARY OF BILL

Your committee has added three provisions to the House bill, H.R. 12599, as well as making relatively minor modifications in the House-passed provisions.

The bill as passed by the House deals with the income tax treatment of a terminal railroad corporation and its railroad shareholders. Under certain court decisions a corporation is taxed on its profits even if it uses these profits to supply services to a shareholder at less than cost. Also, the shareholder is treated as if it had paid at least cost for any services rendered to it and received the profits attributable to the undercharge in the form of a dividend. The bill creates a special exception to these two rules in the case of terminal railroad corporations and their railroad shareholders. Where such a terminal railroad corporation offsets a charge for services performed for a railroad shareholder, by crediting railroad terminal income against this charge, the terminal railroad corporation is not to be treated as having received the portion of the charge so offset, nor is this portion to be rendered taxable to the terminal railroad corporation through the disllowance of deductions. The railroad shareholder is not to be taxed on the portion of the charge satisfied with the related terminal income nor is it to receive a deduction as having paid such portion.

The three new provisions added by your committee to this bill are as follows:

(1) The text of H.R. 12030 (which was reported out unanimously by the Committee on Ways and Means) has been added to the bill. This authorizes the Treasury Department to make special statistical studies, etc., to engage in these studies, etc., jointly with parties requesting them, and to furnish the results of the studies to the parties requesting them upon payment of the cost involved. This provision also authorizes the Treasury Department to admit employees of States, local governments, the Commonwealth of Puerto Rico, U.S. possessions, District of Columbia, and any foreign government to training courses conducted by the Internal Revenue Service and to supply them with texts and other training aids. In this case the Treasury is authorized to require the payment of a reasonable fee not to exceed the cost of the training and training aids. The provision further provides that the payments received from these statistical studies and training courses, etc., as well as other work performed for a State or Federal Government agency are to be used to reimburse the appropriations which bore the cost of this work or services.

(2) A provision has been added amending present law to expressly allow a credit or refund of any tax payment where the Tax Court determines that a claim for refund was filed before the date of the mailing of the notice of deficiency involved and could not have been filed at the time of the mailing of the notice of deficiency. (When a petition is filed in the Tax Court as to any particular taxable year the Tax Court acquires jurisdiction of all issues as to that year, including pending refund claims and pending suits for refund.)

(3) A provision has been added defining cooperative banks in the same manner as domestic savings and loan associations and subjecting them to the same investment requirements, for purposes of determining whether they are to be eligible for the special bad-debt reserve deductions applicable to such organizations. In general this bad-debt reserve deduction under the revenue bill of 1962 is to be equal to the greater of 60 percent of taxable income, or an amount necessary to bring reserves up to 3 percent of loans.

II. INCOME TAX TREATMENT OF TERMINAL RAILROADS AND THEIR SHAREHOLDERS

A. GENERAL EXPLANATION

Under court decisions, if a corporation supplies services to a shareholder at less than cost (making up this loss from profits on business done with other persons), the shareholder is treated as having received a dividend. Moreover, since dividends and other distributions to shareholders are not deductible by the corporation, the profit on the business done with the other persons represents taxable income to it. The courts have reached this latter result under two different theories. In *Anaheim Union Water Co.* (35 T.C. 1072 (1961); now on appeal in the ninth circuit), it was held that the corporation is not entitled to any deductions for expenses attributable to the services rendered the shareholder in excess of the amount charged the shareholder. In *Chicago and Western Indiana Railroad Co.* v. *Commissioner* (seventh circuit, May 1, 1962, affirming Tax Court memo opinion), the terminal corporation was treated as having constructively received from its shareholder the agreed charge for the services rendered, and then as having credited its shareholder with the profit attributable to the business done with other persons.

Because of these decisions, where a number of railroads own a corporation operating a terminal, the terminal corporation remains taxable on the profits earned by it on newstands, restaurants, and similar terminal facilities, even though it uses all of these profits to decrease the charges made to the railroad shareholders for services supplied to them. Thus, as a result of the *Chicago and Western Indiana Railroad Co.* decision, a large amount of tax is now due from terminal railroad corporations for a number of past years.

However, the amount by which the income of the railroad terminal corporation is increased under the decision may also represent the amount by which the railroad shareholders understated their deductions. This can be illustrated by assuming that a railroad terminal corporation had $100 of terminal income from newsstands, restaurants, etc. Under the decision, the terminal corporation would have taxable income of $100 from this source and, at the 52-percent corporate rate, would be liable for tax of $52. Assume further that the railroad shareholders of the terminal corporation were all operated at a profit, that they received services from the terminal corporation costing such corporation $100, and that instead of paying cost for these services the railroad shareholders were credited with the $100 of terminal income. If this $100 credit is treated as being in effect a $100 dividend to the railroad shareholders, and if the railroad shareholders are treated as having paid the full cost of the services (unadjusted by any crediting), there will be a decrease in the tax liability of the railroad shareholders. The $100 dividend received by the railroad shareholders would be eligible for the 85-percent intercorporate dividend received deduction, leaving only $15 of the $100 subject to tax. At a 52-percent rate this would mean a tax of $7.80. At the same time the business deductions of the railroad shareholders would be increased by $100 (the amount of the increase deemed to have been paid for services rendered). Thus, in this case the effect of the court decision is to increase the terminal corporation's tax by $52 and to decrease the railroad shareholder's tax by $44.20 ($52 minus $7.80), an overall net tax increase, for the terminal railroad corporation and its shareholders, of only $7.80.

The hardship arises, however, where the railroad shareholders have net operating losses for a period of years. In such cases there is no comparable decrease in their tax liability. Thus, in the above example if the railroad shareholders have not been paying taxes because of losses, there is the $52 increase in the terminal corporation's tax liability but no comparable $44.20 decrease in the railroad shareholders' income tax. Thus, in cases involving loss railroad corporations the overall net increase in tax in this example is $52 rather than the $7.80 which occurs in the case of railroad corporations with taxable incomes.

Your committee agrees with the House that with the financial problems faced by the railroads at the present time it is undesirable to increase their overall tax burdens. Moreover, it is believed that to do so would not be in harmony with the intent of the President's transportation message. Information available indicates that most of the major railroads are owners of joint facility stock and users of joint facility services. The problem is particularly acute due to the fact that under State law joint facilities to be used by railroads must be operated by a corporation.

Your committee also agrees with the House that it would be particularly unfortunate to make an especially large increase in the tax burden of terminal railroad corporations owned by loss railroads, since the shareholders must bear this additional tax burden.

For the above reasons it has been concluded that special rules should be provided for these terminal railroad corporations so that they will not be taxed on related terminal income which is used to reduce the service charges to the railroads. On the other hand, the railroads involved will not be entitled to expense deductions in excess of the actual costs borne by them.

To accomplish this result the new section is to apply to all years to which the Internal Revenue Code of 1954 or the Internal Revenue Code of 1939 apply. In order to avoid the disappointment of any taxpayer's reasonable expectations, the availability of the operative provisions of this bill for past years has been made to depend on the manner in which the income of a terminal railroad corporation was originally reported by the terminal railroad corporation and its shareholders. Your committee has modified the bill as passed by the House to reopen only those years closed on the date of enactment in which a terminal railroad corporation or its shareholders originally reported income in the manner provided by the bill for such a corporation or its shareholders. Additionally, your committee's amendments provide that adjustments of taxable income available with respect to any closed year which is reopened by this bill are confined to adjustments resulting from the treatment by a terminal railroad corporation or its shareholders of the income of a terminal railroad corporation in the manner provided in the new provision. In each instance in which an adjustment of taxable income for a closed year is available, it becomes so only upon the consent of all of the affected parties to appropriate adjustments for that year.

B. TECHNICAL EXPLANATION

Subsection (a) of the first section of the bill, as amended, adds a new part X to subchapter B of chapter 1 of the Internal Revenue Code of 1954. The new part, which relates to the treatment of terminal railroad corporations and their shareholders, consists of new section 281 which is explained below.

SECTION 281. TERMINAL RAILROAD CORPORATIONS AND THEIR SHAREHOLDERS

(a) Computation of taxable income of terminal railroad corporations

Subsection (a) of section 281 provides special rules for computing the taxable income of a terminal railroad corporation (as defined in sec. 281(d)(1)).

Paragraph (1)(A)(i) of the new section 281(a) provides that a terminal railroad corporation is not to be considered to have received or accrued the portion of any liability of any railroad corporation which is discharged by crediting that liability, if the following conditions are met. The terminal railroad corporation must have discharged, on its books and in fact, that portion of the liability of the railroad corporation payable to the terminal railroad corporation by crediting that liability with an amount of related terminal income (as defined in sec. 281(d)(2)). The liability which is discharged must be a liability with respect to related terminal services (as defined in sec. 281(d)(3)) provided by the terminal railroad corporation to the railroad corporation. Moreover, that portion of the liability must be discharged pursuant to an agreement as provided in section 281(c).

Paragraph (1)(A)(ii) of the new section 281(a) provides that a terminal railroad corporation is not to be considered to have received or accrued the portion of any charge which would be made by the terminal railroad corporation to the railroad corporation but which is not made, if the following conditions are met. The portion of the charge which is not made must result from the terminal railroad corporation having taken related terminal income (as defined in sec. 281(d)(2)) into consideration in computing the net charge to the railroad corporation. The portion of the charge which is not made must be a charge which would otherwise have been made with respect to related terminal services (as defined in sec. 281(d)(3)) provided by the terminal railroad corporation to the railroad corporation. Moreover, the reduction of the charge must have been made pursuant to an agreement as provided in section 281(c).

Paragraph (1)(B) of the new section 281(a) is to apply under the same conditions as under paragraph (1)(A). Paragraph (1)(B) provides that no deduction, which would otherwise be allowable to the terminal railroad corporation under chapter 1 of the 1954 Code, is to be disallowed merely because a liability is discharged as described in paragraph (1)(A)(i). Similarly, no deduction, which would otherwise be allowable to the terminal railroad corporation under such chapter 1, is to be disallowed merely because of the computation of charges as described in paragraph (1)(A)(ii).

Paragraph (2) of the new section 281(a) provides a limitation on the application of paragraph (1). Paragraph (1) is not to apply to the extent that it would (but for this limitation under par. (2)) operate to create (or increase) a net operating loss of the terminal railroad corporation for the taxable year. This limitation is to apply only to taxable years of terminal railroad corporations ending after the date of enactment of the new section 281.

The application of subsection (a) may be illustrated by the following examples:

Example 1.—The X terminal railroad corporation charges its shareholder railroad corporations for the use of its services and facilities on a wheelage or user basis. At the end of each year, the shareholder railroad corporations' liabilities are reduced (in proportion to their respective stock ownership), pursuant to an agreement (as provided in sec. 281(c)), by the net income from all sources (computed without regard to Federal income taxes). For the calendar year 1963, the X corporation charges its shareholders $105 with respect to related terminal services. This liability is discharged in part by crediting it with $36 (the net income from all sources), resulting in a net shareholder liability of $69. The X corporation's income from all sources is determined to be as follows:

Source	Receipts or accruals	Costs of operations	Income (or loss)
(1) Related terminal income from dealings with nonshareholders	$30	$20	$9
(2) Nonrelated terminal income	24	12	12
(3) Related terminal income from dealings with shareholder railroad corporations	105	90	15
Total	159	123	36

Under section 281(a)(1)(A)(i), the X corporation is not to be considered to have received or accrued income of $24 (related terminal income of $9 from nonshareholders and $15 from shareholders), by reason of the discharge of $36 of shareholder railroad corporations' liabilities. Similarly, under section 281(a)(1)(B), to the extent of $24 the X corporation is not to be disallowed deductions by reason of the discharge of shareholder railroad corporations' liabilities.

Example 2.—The Y terminal railroad corporation charges its shareholder railroad corporations for the difference between the cost of operations for the use of its services and facilities provided to the shareholders and its net income from all other sources. This net charge is computed at the end of each year pursuant to an agreement (as provided in sec. 281(c)), which provides that Federal income taxes shall not be taken into account for purposes of the computation. For the calendar year 1964, the Y corporation charges its shareholders $69 with respect to related terminal services. The Y corporation's income from all sources is determined to be as follows:

Source	Receipts or accruals	Costs of operations	Income (or loss)
(1) Related terminal income from dealings with nonshareholders	$30	$21	$9
(2) Nonrelated terminal income	24	12	12
Total	54	33	21
(3) Dealings with shareholders		90	(90)
Due from shareholders			69

Under section 281(a)(1)(A)(ii), the Y corporation is not to be considered to have received or accrued income of $9 (related terminal income) by reason of the $21 charge which is not made. Similarly, under section 281(a)(1)(B), to the extent of $9 the Y corporation is not to be disallowed deductions by reason of the fact that the full cost was not charged.

Example 3.—Assume that all of the facts are the same as in example 2, except that the costs of nonrelated terminal activities are $30, instead of $12. In that case, the nonrelated terminal income will be a minus $6. By reason of the limitation of section 281(a)(2), section 281(a)(1)(A)(ii) and (B) will operate with respect to $3 (instead of $9).

(b) Computation of taxable income of shareholders

Subsection (b) of new section 281 provides special rules for computing the taxable income of a shareholder of a terminal railroad corporation (as defined in sec. 281(d)(1)). This subsection is to apply under the same conditions as under subsection (a)(1)(A). Subject to the limitation provided in subsection (a)(2), no amount is to be considered to have been received or accrued or paid or incurred by a shareholder of a terminal railroad corporation as a result of any discharge of liability described in subsection (a)(1)(A)(i), nor as a result of any computation of charges in the manner described in subsection (a)(1)(A)(ii).

Thus, to the extent that the conditions of subsection (a)(1)(A)(i) or (ii) are satisfied in discharging a liability or computing a charge, a shareholder of the terminal railroad corporation is not to be considered to have paid or incurred an expense. Moreoever, to that extent, the shareholder is not to be considered to have received or accrued a dividend. For example, if in examples 1, 2, and 3, illustrating subsection (a), the X and Y railroad terminal corporations each had three shareholders, and if an equal discharge of liability (or computation of charges) resulted for each shareholder, then each of them will not be considered to have received or accrued a dividend nor paid or incurred an expense of $8 in example 1, and $3 in example 2, and $1 in example 3.

(c) Agreement required

Subsection (c) of new section 281 provides that subsections (a) and (b) are to apply only if the discharge of liability described in subsection (a)(1)(A)(i) or the computation of charges described in subsection (a)(1)(A)(ii) was provided for in a written agreement. The written agreement must have been entered into before the beginning of the taxable year to which subsections (a) and (b) are to apply. All shareholders of the terminal railroad corporation must have been parties to the written agreement. Thus, if a written agreement, to which all of the shareholders are parties, and which was entered into before the taxable year, provides that the net revenues are to be credited as reductions of rental obligations of the shareholders, subsections (a) and (b) would apply to such an arrangement. However, if, for example, the agreement provides that the net revenues are to be divided among the shareholders and that such revenues are not to be applied to reduce liabilities incurred by such shareholders with respect to terminal services but are to be distributed to them in cash or are to be held subject to their unconditional right of withdrawal in cash, then subsections (a) and (b) would not apply to this arrangement.

(d) Definitions

Subsection (d) of the new section 281 defines the terms "terminal railroad corporation," "related terminal income," and "related terminal services."

(1) *Definition of terminal railroad corporation.*—Paragraph (1) of the new subsection (d) contains a definition of a terminal railroad corporation. Such term means a domestic railroad corporation which is not a member, other than as a common parent corporation, of an affiliated group (as defined in sec. 1504 of the code and as determined without regard to whether or not the affiliated group makes a consolidated

return for the taxable year), and which also meets four other requirements.

The first of these requirements provides that all of the shareholders of the terminal railroad corporation must be domestic railroad corporations subject to part I of the Interstate Commerce Act. If any one of the shareholders of a terminal railroad corporation is not so qualified, because, for example, it is a foreign corporation or a corporation not subject to part I of the Interstate Commerce Act, then that terminal railroad corporation would not be within the scope of new section 281.

The second requirement provides that the primary business of the terminal railroad corporation is providing railroad terminal and switching facilities and services to domestic railroad corporations subject to part I of the Interstate Commerce Act and to the shippers and passengers of such railroad corporations. Thus, a terminal railroad corporation would meet this requirement if its primary business consists of the operation of (1) a switching service only, (2) terminal trackage or facilities only, such as a union passenger or freight station, or stockyards, etc., (3) railroad bridges or ferries only, or (4) any combination of the foregoing. For purposes of this requirement, terminal facilities may be provided by leasing such facilities to another railroad corporation.

The third requirement provides that a substantial part of the services rendered by the terminal railroad corporation for the taxable year must be rendered to one or more of the shareholders of the terminal railroad corporation.

The fourth requirement provides that each shareholder of a terminal railroad corporation must compute its taxable income on the basis of a taxable year which begins or ends on the same day as the taxable year of the terminal railroad corporation. This requirement is a slight modification of that contained in the bill as passed by the House. It insures that a short taxable year of a shareholder of a terminal railroad corporation, which might, for example, result from a merger, will not deprive an otherwise qualified terminal railroad corporation of the benefits of the bill.

(2) *Definition of related terminal income.*—Paragraph (2) of the new section 281(d) contains a definition of related terminal income of a terminal railroad corporation. Such term means the income (determined in accordance with regulations prescribed by the Secretary of the Treasury or his delegate) of a terminal railroad corporation derived from any one or more of four sources.

Subparagraph (A) of subsection (d)(2) states that one source of related terminal income includes income derived from services or facilities of a character ordinarily and regularly provided by terminal railroad corporations for railroad corporations or for the employees, passengers, or shippers of railroad corporations. This class of income would include income from switching operations for railroads, and from renting or operating restaurants, barbershops, newsstands, or other similar passenger facilities, in waiting rooms or along passenger concourses. Income from the operation of a small hotel primarily for the employees of the railroads would also be included under this subparagraph. However, the income from the operation of a hotel for passengers or other persons would not qualify as related terminal income. The income produced from making available facilities for railroad shippers (including express companies and freight forwarders), such as sheds or warehouses, although not directly intended for railroad use, would qualify as related terminal income.

Subparagraph (B) of subsection (d)(2) provides that another source of related terminal income includes income derived from the use by persons other than railroad corporations of a portion of a facility, or of a service, which is used primarily for railroad purposes. Thus, for example, if a terminal railroad corporation owns a bridge across a river which has on it both railroad tracks and an automobile roadway, and if the primary purpose for the continued operation of the bridge is to serve railroad corporations, the income derived from the tolls charged automobiles to use the automobile roadway would qualify as related terminal income. Also, if a terminal railroad corporation had a steam plant primarily operated to supply steam for the terminal, but if excess steam is sold to another business in the neighborhood, the income produced by the sale of this steam would qualify as related terminal income. Moreover, income produced either by operating a commuter service or by renting tracks and facilities for a commuter service to an independent operator would qualify as related terminal income. Similarly, the sale or rental of advertising space on either the inside or outside of the terminal for signs and other advertising displays would qualify as related terminal income. However, the income produced by the operation for general public use of a large hotel or office building (whether or not this was physically part of the same structure as the terminal) would not be related terminal income. Likewise, if oil or natural gas or any other mineral is discovered on property owned or leased by the terminal railroad corporation, the income produced from this discovery would not be related terminal income.

Subsection (d)(2) also provides that any substantial addition constructed after the date of enactment of this bill shall be treated as a separate facility for purposes of subsection (d)(2)(B). Thus, for example, if after the date of enactment, a terminal railroad corporation constructs a five-story addition above its present terminal building, which addition is devoted to offices rented to the general public, the income from this addition will not be considered related terminal income, since such addition is not used primarily for railroad purposes. However, the income from the small number of offices which were included in the terminal building before the addition will continue to be considered related terminal income. Furthermore, if a substantial addition constructed after the enactment of this bill is used primarily for railroad purposes, the income from such facility will qualify as related terminal income.

Subparagraph (C) of subsection (d)(2) provides that another source of related terminal income includes income received from any railroad corporation for services or facilities provided by such terminal railroad corporation in connection with railroad operations. This subparagraph would include, for example, income produced by the use of switching facilities, or the lease of such facilities, or the lease or operation of a beltline or bypass railroad. Also included would be income produced by the renting of office space in a terminal office building to any railroad corporation for such corporation's administrative or operating divisions.

Subparagraph (D) of subsection (d)(2) provides that related terminal income includes payment received for facilities or services in connection with mail handling.

Gain realized from the sale of terminals, terminal equipment, and other assets owned by the terminal railroad corporation will not qualify as related terminal income.

(3) *Definition of related terminal services.*—Paragraph (3) of the new subsection (d) contains a definition of related terminal services. Such term means only the services or use of facilities taken into account in computing related terminal income. Included in this term, for example, are switching or terminal services, furnishing terminal trackage or facilities, or operating bridges or ferries for railroad purposes.

(*e*) *Application to taxable years ending before the date of enactment*

Subsection (e) of the new section 281 provides two rules for applying section 281 to taxable years ending before the date of enactment of section 281. Paragraph (1) of this subsection applies to all cases whether or not the taxable year involved of one or more of the parties is closed. Paragraph (2) only applies when the taxable year of one or more of the parties is closed.

Paragraph (1) of the new section 281(e) provides, for taxable years ending before the date of enactment of this section, that section 281 is to apply to a terminal railroad corporation (as defined in sec. 281(d)(1)) only to the extent that it had computed its taxable income on its return in the manner described in section 281(a). Similarly, section 281 is to apply to a shareholder of a terminal railroad corporation only to the extent that it had computed its taxable income on its return in the manner described in section 281(b). The return on which the taxable income is required to have been computed in the described manner must have been filed on or before the due date (including the period of any extension of time) for filing the return for the applicable taxable year.

The application of paragraph (1) may be illustrated by the following example:

Assume that all of the facts are the same as in example 1 illustrating subsection (a), except that the calendar year 1954 is the year involved. Assume further, that of the related terminal income from dealings with nonshareholders of $9, $3 is attributable to income derived from the United States in payment for services in connection with mail handling, and that this $3 was reflected in taxable income on the return of the X terminal railroad corporation. Under section 281(a), the X terminal railroad corporation is not to be considered to have received or accrued income, nor is it to be disallowed deductions, by reason of the discharge of shareholder railroad corporations' liabilities, of $21 (instead of $24).

Assume, additionally, that the X terminal railroad corporation had three shareholders and an equal discharge of liability resulted for each of them. Since each shareholder treated this $1 discharge of liability (attributable to income derived from the United States in connection with mail handling) as a dividend, on its return, each shareholder will not be considered to have received or accrued a dividend nor paid or incurred an expense of $7 (instead of $8).

Paragraph (2) of the new section 281(e) contains four special provisions for applying section 281 to a taxable year for which either assessment of any deficiency, or refund or credit of any overpayment, whichever is applicable, is barred by operation of any law or rule of law. This paragraph will not apply to a taxable year for which either assessment or refund is barred by a closing agreement, a compromise, or a decision of the Tax Court entered pursuant to a stipulated settlement. This paragraph will apply to a taxable year of a terminal railroad corporation only if refund or credit of any overpayment for such taxable year was barred on the date of the enactment of this section.

Subparagraph (A) of subsection (e)(2) provides that this paragraph is to apply only to the extent that overpayment of income tax would result if the terminal railroad corporation were permitted to recompute its taxable income in the manner described in subsection (a).

Subparagraph (B) of subsection (e)(2) provides that this paragraph is to apply only if claim for credit or refund of overpayment which would result from the recomputation described in subparagraph (A) is filed prior to 1 year after the date of enactment of this section.

Subparagraph (C) of subsection (e)(2) provides that this paragraph is to apply only to the extent that the terminal railroad corporation computed its taxable income in the manner described in subsection (a) on its timely filed return for such taxable year.

Subparagraph (D) of subsection (e)(2) provides that this paragraph is to apply only if each railroad corporation, which was a shareholder of the terminal railroad corporation during such taxable year, consents in writing to the assessment of any deficiency for any year to the extent attributable to the recomputation of its taxable income in the manner described in subsection (b) correlative to its allocable share of the adjustment of taxable income made by the terminal railroad corporation in its recomputation under subparagraph (A). This assessment period may be extended to any time to which the taxpayer and the Secretary of the Treasury or his delegate may agree. The consent will extend the assessment period even though the assessment of the deficiency would otherwise be prevented by the operation of any law or rule of law at the time of filing the consent.

(f) Regulations

Subsection (f) of the new section 281 requires the Secretary of the Treasury or his delegate to prescribe such regulations as may be necessary to carry out the purposes of the new section 281.

Subsection (b) of the first section of the bill provides a clerical amendment to the table of parts for subchapter B of chapter 1 of the Internal Revenue Code of 1954.

Section 2(a) of the bill provides that the amendments made by the bill to the Internal Revenue Code of 1954 are to apply with respect to taxable years beginning after December 31, 1953, and ending after August 16, 1954.

Section 2(b) of the bill provides that provisions having the same effect as the amendments made by the bill to the Internal Revenue Code of 1954 are to be deemed to be included in the Internal Revenue Code of 1939, effective with respect to all taxable years to which the Internal Revenue Code of 1939 applies.

III. STATISTICAL STUDIES BY INTERNAL REVENUE SERVICE

A. GENERAL EXPLANATION

Statistics of Income which the Internal Revenue Service has prepared and published annually for over 40 years has become an essential part of the basic Federal data used by many governmental and private organizations and persons. Many of these users would like, however, to obtain additional items or classifications of data which are not published in Statistics of Income. States, for example, have requested additional information which can be obtained only from Federal income tax returns. Up to the present such information has been refused or, in rare instances, made available in part under cumbersome conditions. The reason is the Service is unable to receive payment for the additional work and, therefore, has no way of paying for the additional costs incurred by it in making the studies, etc. Instead, where payment is received the payment is covered into the general miscellaneous receipts of the Federal Government. Similarly, private organizations and individuals engaged in research have also been refused information that they either cannot obtain from other sources or can obtain only at much greater cost from other sources.

Other Federal agencies already are authorized to receive reimbursement for statistical and other services similar to those of the Internal Revenue Service for which reimbursement would be provided by this bill. These agencies are the Bureau of the Census, the Department of Labor, and the Department of Health, Education, and Welfare. The Department of Labor has had the authority since 1934 to prepare certain statistical compilations from its records upon payment of the actual costs of the work by the persons requesting it. The Secretary of Labor commenting on the proposed legislation with respect to the Treasury Department indicated that in the case of the Department of Labor much valuable data has been compiled by it in this manner. As a result, the Department of Labor favored enactment of this legislation enabling the Treasury Department to perform similar services on such a basis. In this connection the Secretary of Labor noted that the proposed studies would be subject to existing laws and regulations regarding unauthorized disclosure of information.

Policy guidelines to be followed in carrying out reimbursable statistical studies, etc., already are provided by the Bureau of the Budget in its statement of principles which appears below. Among these principles is the requirement that no agency arrange for supplementary processing of statistical materials which would interfere with the regular statistical program of the agency. Also, these principles provide that an agency should only make those special tabulations as appear to be justified in light of the limitations of the data if these tabulations are to be available for general use, or possible publication. It is further provided that special tabulations are to be available for publication both by the Federal agency and the outside sponsor except where the data are not to be published and are to be used only for special analysis.

In view of the above considerations your committee has added a provision to this bill amending the Internal Revenue Code to authorize the Secretary of the Treasury or his delegate to make special statistical studies and compilations involving data taken from tax returns, declarations, etc., to engage in special studies or compilations jointly with parties making such a request, and to furnish transcripts of these special studies or compilations to the parties making the request where they pay the cost of the work performed.

The bill also authorizes the Secretary of the Treasury or his delegate to admit employees and officials of States, the Commonwealth of Puerto Rico, possessions of the United States, local governments of any of the above, the District of Columbia, or of foreign governments to training courses conducted by the Internal Revenue Service and to supply them with texts and other training aids. In this case the Secretary of the Treasury may require the payment of a reasonable fee not to exceed the cost of the training and training aids.

The bill also provides that the payments received for the special statistical studies, compilations and other services, and the payments received for supplying training and training aids, together with payments received for any other services performed by a State or Federal agency in supplying copies of data from tax returns, etc., is to be deposited in a separate account. This separate account is then to be used to reimburse the appropriations which bore the cost of the work or services "or to refund excess sums when necessary."

B. STATEMENT OF PRINCIPLES; AVAILABILITY OF FEDERAL STATISTICAL MATERIALS TO NONGOVERNMENTAL RESEARCH WORKERS

I. Federal statistical and administrative data-collection programs often produce records capable of valuable statistical analysis beyond that which can or should be carried out by the collecting agency or any other agency of the Federal Government. In order that the optimum benefit may be obtained from Federal data-collection activities it should be the policy of the Federal Government to allow and to encourage the further analysis of these materials, under appropriate arrangements, by or on behalf of nongovernmental research workers.

II. Although some general principles may be offered for the guidance of agencies with such statistical materials in making them available for further processing, each such agency must determine and assume responsibility for its policies and procedures in the light of the nature of its program and data and the demands for its data.

III. No agency should enter into any arrangement for the supplementary processing of statistical materials, regardless of whether reimbursement is provided, which will interfere with the regular statistical program of the agency.

IV. In general, requests for further analysis of Government data should be met as fully as possible by making special tabulations to the specifications of outside users.

1. While a priority should be given to bona fide research uses in the general public interest, special tabulations should be permissible for all legitimate uses, both public and private, including, for example, marketing studies.
2. The same rules for protecting confidentiality of individual responses must apply to special tabulations as are applied to the regular tabulation program.

3. The agency should make only such special tabulations as appear to it to be justified in the light of the limitations of the data when the tabulations are to be available for general use or possible publication. Less exacting standards are permissible only when the data are not to be published but used for special analysis by competent analysts fully aware of the limitations.

4. To the extent that special tabulations are deemed to serve a special, as distinguished from the general public, interest, the full costs shall be charged to the sponsors of the tabulation.

5. Special tabulations should be in the public domain, available for publication by both the Federal agency and the outside sponsor, except as provided in IV, 3, above.

V. Research needs which cannot be adequately served by special tabulations can under proper circumstances be met by allowing nongovernmental workers to work with the raw materials, worksheets, and other intermediate materials within the agency.

1. Such an arrangement is appropriate for research projects in the general public interest which would not be carried out without private sponsorship.

2. The agency should take appropriate steps to insure that candidates for this privilege meet appropriate standards of competence and integrity.

3. The agency should expect to instruct such workers as to the source, characteristics, and limitations of the data, and to cooperate with them, but it may properly set reasonable limits on the extent to which its own staff and facilities are committed to the project.

4. While the agency should give to the results of the research such technical review, from the point of view of presentation and use of agency data, as it deems feasible and appropriate, the agency assumes no responsibility for these results. Any publication based on them should include a clear disclaimer to that effect.

5. The agency should take whatever steps are necessary to protect the confidentiality of the data supplied by individual respondents, subject to the usual penalties for disclosure and other requirements of the agency law.

VI. Under extraordinary circumstances an agency may make available to outside research workers copies of original data or intermediate materials which involve no disclosure of confidential data for further processing outside the agency. This arrangement is appropriate only for studies clearly in the public interest, too complex to be carried on under other arrangements, to be carried out by workers of known competence to make valid use of the materials, working in close cooperation with the agency staff.

VII. Appropriate advance planning by agencies will promote maximum exploitation of data collected by the Federal Government by one or another of the above methods. Anticipation of demands for further tabulations beyond those planned for publication may be reflected in questionnaire design, card design, and tabulation procedures. The relatively few surveys which lend themselves to duplication of orignial materials for use outside the agency can probably be identified in advance, so that planning may take this use into account. In general, any steps to make the survey procedure a matter of systematic record, intelligible to other competent research workers, will aid users to make valid use of the data.

IV. ALLOWANCE OF REFUND WHERE TAX COURT HAS ACQUIRED JURISDICTION OF SUIT FOR REFUND

Generally under present law if the taxpayer decides to have his case determined by the district court or Court of Claims, he must pay the income tax in question and sue for a refund. On the other hand, if the Internal Revenue Service asserts a deficiency, the taxpayer may file a petition in the Tax Court and the case is then tried in that court without payment of the tax.

A problem has arisen as a result of this difference in jurisdiction in the case of refunds and deficiencies. Present law provides that if a taxpayer files a timely refund claim or timely suit for refund of taxes in a district court or Court of Claims, if subsequently the Government sends a notice of deficiency to such taxpayer with respect to the same tax and year and a petition is filed in the Tax Court, the proceedings on the two issues are to be tried together in the Tax Court, and the district court or Court of Claims loses jurisdiction over the suit for refund (sec. 7422(e) of the code).

The problem arises because a section of present law (sec. 6512(b)(2)) has been interpreted by some as meaning that where the Tax Court finds an overpayment was made, the refund must be limited to the total of (1) the amounts paid after the mailing of the notice of deficiency and (2) the amounts paid before the mailing of the notice of deficiency where a valid claim for refund could have been filed on the date of this mailing. The problem which arises is whether any refund can be made if at the time the Government's deficiency notice was mailed the taxpayer had previously filed a claim for refund and could not on that date have filed such a claim. Situations of this type are likely to occur, for example, where the deficiency can be asserted under the 6-year statute of limitations, because the amount asserted as omitted from gross income equals 25 percent or more of the total income involved.

This result could not have occurred under the 1939 Code and, although language changes were made when the 1954 Code was enacted, there is no indication that any change in this respect was intended. The committee reports on the section of the code in question (sec. 6512), for example, indicate that the section contains no material change from the 1939 Code although some clarifying changes were made. Since the 1954 enactment, moreover, the Internal Revenue Service has in practice interpreted the law as permitting the refund of amounts where valid claims have been timely filed, as well as where these claims could have been filed on the date of the mailing of the notice of deficiency.

Your committee believes it is desirable to amend the language of present law (sec. 6512(b)(2)) to make it clear that the statute conforms with the interpretation of this section followed by the Service since the enactment of the 1954 Code.

The bill amends present law (sec. 6512(b)(2)) to expressly allow a credit or refund of any portion of the tax where the Tax Court determines that this portion of the tax was paid within the appropriate period (as provided by sec. 6511 (b)(2), (c), or (d)) and with respect to which a timely claim for refund has been filed before the date of the mailing of a notice of deficiency. However, this claim for refund must not have been disallowed before the date of the mailing of the deficiency notice, or if it was, it must have been possible for a timely suit for refund to have been commenced on that date or it must be the subject of a suit for refund which had been commenced before that date (and within the period specified in sec. 6532, relating to the periods of limitations on suits for recovery of any internal revenue tax, penalty, or other sum).

The application of this amendment can be illustrated by the following examples:

Example 1.—X, a taxpayer files an income tax return for 1961 and pays the tax on April 15, 1962. On March 15, 1965 (within the 3-year period of limitation set forth in sec. 6511(a), for filing claims for refund), X files a claim for refund of $1,000 relating to the April 15, 1962, return. On October 1, 1965, a notice of deficiency is mailed to the taxpayer. In the October 1, 1965, deficiency letter, the Commissioner alleges that X has failed to report 25 percent or more of his gross income in the April 15, 1962, return of tax, thus permitting the Service to assert a deficiency within 6 years of the date the return was filed. X petitions for a redetermination of his tax for 1961 in the Tax Court, and the Tax Court sustains him, finding an overpayment of $1,000. Under new subparagraph (C)(i), X will recover the $1,000 since his refund claim was filed within the 3-year period set forth in section 6511(a) and before the date of the mailing of the notice of deficiency and since the claim was not disallowed before such date.

Example 2.—Assume the facts are the same as in example 1, and assume further that X's claim for refund had been disallowed on September 1, 1965. Since X's claim had been disallowed before the mailing of the notice of deficiency (on October 1, 1965), and since under section 6532 of the code, X has until September 1, 1967, to file a timely suit for refund, the provisions of new subparagraph (C)(ii) will permit X's overpayment to be refunded to him.

Example 3.—Assume the facts are the same as in examples 1 and 2 and that on September 15, 1965, X commences suit for refund of the tax in a district court. After the notice of deficiency is mailed to him on October 1, 1965, X files a petition with the Tax Court, with the result that under provisions of section 7422(e), jurisdiction of the entire subject matter of X's suit in the district court becomes lodged in the Tax Court. Since X has commenced suit before the mailing of the notice of deficiency and prior to September 1, 1967, his refund suit is timely and under provision of new subparagraph (C)(iii) refund of the entire $1,000 overpayment may be made.

V. COOPERATIVE BANKS

Under present law cooperative banks, together with domestic building and loan associations and mutual savings banks are allowed additions to a reserve for bad debts. Under present law this addition may represent the entire taxable income of the organization or an amount which will bring surplus, undivided profits, and reserves at the beginning of the year up to 12 percent of total deposits or withdrawable accounts at the end of the year.

The revenue bill of 1962, which has been passed by both the House and Senate and on which the conference has been held, modifies substantially the provision relating to additions to reserves for bad debts allowed cooperative banks, domestic building and loan associations, and mutual savings banks. In general terms, this bill as passed by Congress would allow a deduction for these institutions equal to whichever of the following is the greatest:

(1) Sixty percent of taxable income for the year computed before a bad debt deduction;

(2) An amount sufficient to bring the balance of the reserve for losses on qualifying real property loans to 3 percent of such loans outstanding at the close of the taxable year (up to 5 percent in the case of certain new companies), plus an amount sufficient to bring the balance of the reserve for losses on other loans up to a reasonable amount; or

(3) If the institutions demonstrate a need for a reserve greater than is permissible under the other two, an amount sufficient to bring the overall balance of its reserves up to a "reasonable" amount.

The deductions specified above are limited in that if the taxpayer uses alternatives Nos. (1) or (2), the deduction allowed may not increase the reserve for losses on qualifying real property loans, together with the reserve for losses on nonqualifying loans and surplus, undivided profits, and other reserves to more than 12 percent of total deposits or withdrawable accounts. In addition, no deduction may be taken under alternative No. 1 described above to the extent that such a deduction would increase the reserve for losses on qualifying real property loans to more than 6 percent of these loans.

The revenue bill of 1962 also contains a definition of a domestic building and loan association which must be met before one of these institutions is eligible for the preferred deduction for an addition to reserves, as described above.

In adopting the definition for a domestic building and loan association in the revenue bill of 1962, the report of your committee indicated that there had been problems with the definition in present law because loans in many cases now are in substance not loans made to members. It was indicated that technical conformance has been maintained with the membership requirement of present law by making borrowers of funds, members of the institutions. Nevertheless, questions have been raised as to the substance of these provisions. In this respect the report of your committee on the revenue bill of 1962 stated as follows:

> As a result, your committee has concluded that the definition of a domestic building and loan association, eligible for the tax treatment described above, should be brought more nearly into conformance with actual practice. At the same time it was deemed desirable to restrict this tax treatment to those primarily engaged in making residential real estate loans, with special emphasis on 1- to 4-family units, and omitting from the definition cases such as those where these institutions have been used for speculative purposes.

As a result, the revenue bill of 1962 defines a domestic building and loan association as one which meets a series of requirements set forth in that bill. No reference is made in this regard, however, to a cooperative bank. Although the bill permits a cooperative bank the same deduction as a domestic building and loan association, it provides no specific definition of what constitutes a cooperative bank. Generally it is understood that cooperative banks are essentially the same type of organization and carrying on essentially the same type of activity as a domestic building and loan association. This is indicated, for example, in a State court case wherein it is stated with respect to a domestic building and loan association:

> The business of the association is substantially similar to that conducted by our State chartered cooperative banks. Both appeal to the same type of investor and to the same class of borrowers. Their investments and loans are practically identical in character (*Commissioner of Corporations and Taxation* v. *Flaherty*, 306 Mass. 461, 28 N.E. 2d 433, cert. denied, 312 U.S. 680).

The desirability of providing the same restrictions for cooperative banks as for domestic building and loan associations is a matter which it is understood was recognized by the conferees on the part of the House and Senate on the revenue bill of 1962. However, because a new definition applicable to cooperative banks was not a matter which was in conference on that bill, no action could be taken on this matter at that time.

In view of the considerations set forth above, your committee has concluded that it is desirable to amend the law to provide essentially the same definition for a cooperative bank as the revenue bill of 1962 will provide in the case of domestic building and loan associations. This provision which makes such a definition applicable to cooperative banks, before they may qualify for the special deduction for additions to bad debt reserves, is to be effective with respect to such institutions for taxable years beginning after the date of enactment of the Revenue Act of 1962.

This section provides that cooperative banks are those without capital stock and operated for mutual purposes and without profit which meet two sets of conditions which the revenue bill of 1962 makes applicable in the case of domestic savings and loan associations. The first set of requirements is that the cooperative bank be an insured institution within the meaning of section 401(a) of the National Housing Act or one which is subject by law to supervision and examination by State or Federal authority having supervision over such banks. The second set of requirements is that the cooperative bank must meet the same requirements as are set forth in subparagraphs (B), (C), (D), (E), and (F) of paragraph (19) of section 7701(a) of the code as provided by the revenue bill of 1962 for domestic building and loan associations.

The first of these provisions provides that a cooperative bank qualifies only if substantially all of its business consists in accepting savings and investing in loans secured by, or for the improvement of, real property described below. This restriction is not designed to prevent a cooperative bank from buying or selling participations in its other loans but it is anticipated that this will prevent a cooperative bank from carrying on the business of brokerage mortgage paper if this represents any substantial part of its business. Moreover, it is not intended that this prevent necessary or desirable borrowings from Government agencies.

Another restriction on qualified cooperative banks requires them to invest at least 90 percent of their assets in—

(1) Cash,

(2) Obligations of the United States or of a State or local government, stock or obligations of a corporate instrumentality of the United States or of a State or local governmental unit, and certificates of deposits in, or obligations of, a corporation organized under a State law which specifically authorizes the corporation to insure the deposits (or share accounts) of member cooperative banks,

(3) Loans secured by an interest in real property, including so-called improvement loans,

(4) Loans secured by a deposit (or share) of a member,

(5) Property acquired through the default of real property loans, and

(6) Property used by the cooperative bank in the conduct of its qualified business.

Of the 90 percent of total assets referred to above, at least 80 percent (72 percent of total assets) must be invested in—

(1) Loans secured by an interest in, or made for the improvement of, real property (including tract loans where the tract is to be improved),

(2) Loans secured by, or made for the improvement of, real property used primarily for church purposes,

(3) Cash,

(4) Obligations of the United States or of a State or local government, stock or obligations of a corporate instrumentality of the United States or of a State or local governmental unit, and certificates of deposit in or obligations of a corporation organized under a State law which specifically authorizes the corporation to insure deposits or share accounts of member cooperative banks,

(5) Loans secured by a deposit (or share) of a member,

(6) Property used by the cooperative bank in the conduct of its qualified business, and

(7) Property acquired through the default of any of the loans described above.

In addition, at least 60 percent of this 90 percent of total assets (54 percent of total assets) must be invested in loans secured by an interest in real property which is residential real property containing one- to four-family units (or loans made for the improvement of such property or tract loans with respect to such property), or for any of the purposes specified in Nos. 2 through 7 above.

The definition also provides that a qualifying cooperative bank may not invest more than 18 percent of its total assets in other than residential real property loans and categories Nos. 2 through 7 listed above. Similarly, the provision provides that not more than 36 percent of the total assets may be invested in other than one- to four-family unit residential real property and categories Nos. 2 through 7 listed above. However, under some circumstances this "36 percent" requirement may be increased to as much as 41 percent. Where this occurs, however, the revenue bill of 1962 reduces the maximum allowable addition to the reserve for losses on qualifying real property loans, if either the 60 percent of taxable income or the 3 percent of reserves methods are used, according to the following table:

If the percentage exceeds—	But does not exceed—	The reduction shall be the following proportion of the amount otherwise determined—
36 percent	37 percent	1/12
37 percent	38 percent	1/6
38 percent	39 percent	1/4
39 percent	40 percent	1/3
40 percent	41 percent	5/12

A cooperative bank may qualify for the reduced deduction where it misses the "36 percent" requirement but comes within the range of the "41 percent" requirement only (1) in the cooperative bank's first taxable year beginning after the date of enactment of the revenue bill of 1962, or (2) if it met the 36 percent requirement for the immediately preceding year or (3) if it met at least the 41 percent requirement for the preceding year.

One further requirement provides that not more than 3 percent of the assets of the cooperative bank may be invested in stock of any corporation other than those listed in category No. 4 immediately above.

The percentages referred to above may be determined on the basis of the average assets outstanding during the taxable year or on the basis of those outstanding at the close of the taxable year

VI. DEPARTMENTAL REPORTS

TREASURY DEPARTMENT,
Washington, September 20, 1962.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: This is in reference to H.R. 12599, now pending before your committee, to modify the income tax treatment of terminal railroad corporations and their railroad shareholders.

The purpose of this bill is to relieve the Chicago & Western Indiana Railroad Co., a terminal railroad corporation, and other terminal railroad corporations similarly situated, of the effect of the decision in *Chicago and Western Indiana Railroad Co.* v. *Commissioner*, C.A. 7th, May 1, 1962, 303 F. 2d 796. The C. & W.I. Railroad Co., like most other terminal facilities which are jointly owned by railroads using the facility, operates under a common basic rental agreement between the facility and its railroad shareholders. Under this terminal-owner agreement, the C. & W.I. applied gross income obtained from concessions and the rendering of services to railroad users other than the shareholders, referred to herein as "nonowner income," against the cost of operation of the terminal facility, and the shareholders were obligated to make payment of the remaining deficit. In the above-cited case, the Court of Appeals for the Seventh Circuit declared an amount equal to this nonowner income was taxable to the terminal corporation under two theories: (1) That there was a constructive receipt by the terminal from its shareholders of an amount equal to the nonowner income credited to the shareholders, and (2) that to the extent of the nonowner income credited to its shareholders, the terminal may not treat its expenses in providing services and facilities to its shareholders as "ordinary and necessary" business expenses.

The tax consequences of the above decision, in addition to the taxation of the nonowner income to the terminal, are (1) that the shareholders become entitled to additional rental deductions equal to their respective shares of the cost of operating the facility which was defrayed by application of the nonowner income, and (2) the shareholders are considered to have received constructive dividends equal to the nonowner income so applied. Only 15 percent of the constructive dividends would be includible by the shareholders in view of the 85-percent intercorporate dividend deduction.

Normally the increase in tax to the terminal corporation attributable to inclusion of the nonowner income would be offset by the reduction in tax to the shareholders attributable to the additional rental deductions, except for the tax on the 15-percent intercorporate dividend. However, in the case of the Chicago & Western Indiana Railroad Co., the shareholder railroads had substantial and continuing operating losses for most of the taxable years involved. Thus, the additional rental deductions to them would be wasted. Pursuant to their obligations as guarantors of liabilities of the C. & W.I., the shareholder roads would have to make up the additional taxes imposed on C. & W.I. of approximately $12 million with no effective offset in their own tax liabilities. Evidence has been presented that imposition of this additional financial burden may result in bankruptcy of one or more of the shareholder roads.

It has come to our attention that in the case of some other terminal corporations the shareholder railroads would be entitled to refunds by virtue of the additional rental deductions under the above decision, but the United States would not be able to collect the offsetting additional taxes from the terminal corporation. This situation arises because the statute of limitations has run as to most terminal corporations for years prior to 1958 whereas the taxable years of most of the shareholder roads are still in the process of audit for several years prior to 1958. This windfall to certain shareholder railroads could involve a substantial revenue loss.

The Department believes a legislative solution should be found to the problems arising as a result of the decision in *Chicago & Western Indiana Railroad Co.* which does not impose serious financial burdens on the shareholder railroads as a consequence of required terminal operations, both prospectively and retroactively, and which will prevent windfall refunds to certain shareholder railroads as above described. The Department has cooperated with representatives of the railroad industry, and particularly with representatives of the shareholder railroads of the Chicago & Western Indiana Railroad Co., in working out the solution presently embodied in H.R. 12599, which it is believed will attain the above objectives.

Essentially the bill provides for income tax treatment of railroad terminals and their shareholder railroads which is comparable to the tax practice of such terminals and shareholders prior to the decision in *Chicago & Western Indiana Railroad Co.* Thus, where a terminal railroad corporation offsets a charge for services performed for a railroad shareholder, by crediting railroad terminal income against this charge, the terminal railroad corporation is not to be treated as having received the portion of the charge so offset, nor is this portion to be rendered taxable to the terminal railroad corporation through the disallowance of deductions. The railroad shareholder is not to be taxed on the portion of the charge satisfied with the terminal income nor is it to receive a deduction as having paid such portion.

The bill limits the benefit of the above rule to the crediting of "related terminal income" which concept, as defined in the bill, includes nearly all terminal railroad income today but acts as a limitation to prevent possible abuse of this provision in the future. The bill also requires that the crediting against the shareholder liability must be pursuant to written agreement, which is in accord with prior practice of the terminal railroads and their shareholders, and the liability must be for services, or the use of facilities, taken into account in computing related terminal income.

The amendments made by H.R. 12599 are to apply with respect to all taxable years subject to the Revenue Code of 1954 and to years subject to the Internal Revenue Code of 1939. In this connection a question has arisen as to whether the retroactive application of these amendments is constitutional. Although it is believed that the retroactive application of these amendments is constitutional, the question is not entirely free from doubt. Under these circumstances, the Department suggests it may be desirable to modify slightly the retroactive application of the bill. A suggested amendment to accomplish this objective is attached hereto for your consideration.

For the reasons stated above, the Department favors enactment of H.R. 12599.

The Bureau of the Budget has advised the Treasury Department that there is no objection from the standpoint of the administration's program to the presentation of this report.

Sincerely yours,

STANLEY S. SURREY,
Assistant Secretary.

PROPOSED AMENDMENT TO SECTION 281

Redesignate subsection (e) as subsection (f), and in lieu thereof insert the following:

"(e) *Application to taxable years ending before the date of enactment.*—In the case of any taxable year ending before the date of the enactment of this section—

"(1) this section shall apply only to the extent that the taxpayer computed on its return, filed at or prior to the time (including extensions thereof) that the return for such taxable year was required to be filed, its taxable income in the manner described in subsection (a) in the case of a terminal railroad corporation, or in the manner described in subsection (b) in the case of a shareholder of a terminal railroad corporation; and

"(2) this section shall apply to a taxable year for which the assessment of any deficiency, or for which refund or credit of any overpayment, whichever is applicable, was prevented, on the date of the enactment of this section, by the operation of any law or rule of law (other than section 3760 of the Internal Revenue Code of 1939 or section 7121 of the Internal Revenue Code of 1954, relating to closing agreements, section 3761 of the Internal Revenue Code of 1939 or section 7122 of the Internal Revenue Code of 1954, relating to compromises, and other than a decision of the Tax Court entered pursuant to a stipulated settlement), only—

"(A) to the extent any overpayment of income tax would result from the recomputation of the taxable in come of a terminal railroad corporation in the manner described in subsection (a),

"(B) if claim for credit or refund of such overpayment, based upon such recomputation, is filed prior to one year after the date of the enactment of this section,

"(C) to the extent that paragraph (1) applies, and

"(D) if each shareholder of such terminal railroad corporation consents in writing to the assessment, within such period as may be agreed upon with the Secretary or his delegate, of any deficiency for any year to the extent attributable to the recomputation of its taxable income in the manner described in subsection (b) correlative to its allocable share of the adjustment of taxable income made by the terminal railroad corporation in its recomputation under subparagraph (A)."

TREASURY DEPARTMENT,
Washington, September 27, 1962.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: This is in response to your request for this Department's views on H.R. 12030, a bill to amend the Internal Revenue Code of 1954 with respect to moneys received in payment for special statistical studies and compilations and certain other services.

This bill incorporates the substance of a draft of proposed legislation submitted by the Secretary of the Treasury on February 1, 1962, to the Speaker of the House of Representatives and to the President of the Senate. The purpose of this proposed legislation is to permit moneys received in payment for certain services rendered by the Internal Revenue Service on request to be deposited in a separate account which may be used to reimburse appropriations which bore the expense of such services. Under existing law, amounts received in reimbursement for such services must be paid into the Treasury of the United States as internal revenue collections and, since the Service is not able to use these amounts, the full cost of such services must be charged to appropriations. Consequently, many requests for authorized special services on programs for which demand is irregular and unpredictable, although of a worthy nature, must be denied by the Service.

The proposed legislation would remove existing obstacles to performance by the Service of many of the requests received by it for the services to which the legislation applies. Such services include special statistical studies and compilations involving data available in connection with the statistics published annually by the Service, the furnishing of instruction to those employees and officials of States and other governmental entities admitted to the training courses of the Service, and the supplying of texts and other training aids for the use of such governmental entities; and furnishing to States or departments or agencies of the Federal Government of copies of, or data from, returns, statements, or other documents filed under authority of the code and of records maintained by the Service in connection with the administration of the code.

This bill was reported favorably on September 14, 1962, by the Committee on Ways and Means, but the House of Representatives has not yet had time to consider the bill. The Treasury Department recommends enactment of the provisions of this bill during this Congress. Therefore, we request that you add the provisions of this bill to H.R. 12599, to modify the income tax treatment of terminal railroad corporations and their railroad shareholders, which is now pending before your committee.

The Bureau of the Budget has advised the Treasury Department that there is no objection from the standpoint of the administration's program to the presentation of this report.

Sincerely yours,

STANLEY S. SURREY,
Assistant Secretary.

TREASURY DEPARTMENT,
Washington, September 17, 1962.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: A procedural defect in the provisions of the Internal Revenue Code, which could have the effect of barring the payment of an otherwise valid and timely claim for refund, recently has been called to the attention of the Treasury Department. This situation can arise where the Tax Court acquires jurisdiction of a taxpayer's timely suit for refund pursuant to section 7422(e) of the code, decides the refund issue favorably to the taxpayer, but the overpayment so determined cannot be allowed by reason of a technical and presumably unintended, deficiency in the wording of section 6512(b)(2) of the code.

Section 6512(b)(2) provides that no refund of an overpayment determined by the Tax Court shall be allowed unless the Tax Court also determines that the overpayment was paid either (1) after the mailing of the notice of deficiency which originally gave jurisdiction to the Tax Court, or (2) at such a time that the taxpayer could have filed a timely claim for refund on the date the notice of deficiency was mailed. This provision works satisfactorily in all cases except where the period of limitations on the Commissioner's right to issue a deficiency is longer than the period of limitations on filing a claim for refund. In the latter case, however, a refund based on a timely claim may be barred by the technical wording of section 6512(b)(2) because, even though an actual claim for refund was filed before the mailing of the notice of deficiency, the period of limitation on filing a claim may have expired at the time the notice of deficiency was mailed. The Internal Revenue Service has examined this matter and, although it is not aware of any case where a taxpayer has been denied a refund due to this defect, the Service agrees that a literal reading of section 6512(b)(2) would require this unfortunate result.

This result could not have occurred under the 1939 code because the provisions of section 7422(e), which were designed to prevent the concurrent jurisdiction in tax disputes of the Tax Court on the one hand and the various district courts and the Court of Claims on the other, were first enacted in the 1954 code. The language of section 6512(b)(2), however, was not technically refined sufficiently to accommodate this change in procedure.

We are informed that a case has arisen in which a taxpayer's timely claim for refund may be barred by the operation of this technical defect unless corrective legislation is enacted. The Treasury Department believes that such legislation merits favorable consideration by the Congress.

Enclosed for your consideration is a draft of an amendment to section 6512(b)(2) which is designed to correct this defect.

The Bureau of the Budget has advised the Treasury Department that there is no objection from the standpoint of the administration's program to the presentation of this report.

Sincerely yours,

STANLEY S. SURREY,
Assistant Secretary.

VII. CHANGES IN EXISTING LAW

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

DRAFT AMENDMENT TO SECTION 6512(*b*)(*2*)

(New material in italic, deleted material in black brackets)

(2) LIMIT ON AMOUNT OF CREDIT OR REFUND.—No such credit or refund shall be allowed or made of any portion of the tax unless the Tax Court determines as part of its decision that such portion was paid—

(A) after the mailing of the notice of deficiency, **[**or**]**

(B) within the period which would be applicable under section 6511 (b)(2), (c), or (d), if on the date of the mailing of the notice of deficiency a claim had been filed (whether or not filed) stating the grounds upon which the Tax Court finds that there is an overpayment **[**,**]**, *or*

(C) *within the period which would be applicable under section 6511 (b)(2), (c), or (d), in respect of any claim for refund filed within the applicable period specified in section 6511 and before the date of the mailing of the notice of deficiency—*

(i) which had not been disallowed before that date,

(ii) which had been disallowed before that date and in respect of which a timely suit for refund could have been commenced as of that date, or

(iii) in respect of which a suit for refund had been commenced before that date and within the period specified in section 6532.

O